

ORIGINAL PAPER

Citation: Mitkus, T., & Maditinos, D. I. (2017). Analysis of state aid policy to stimulate innovation and internationalization in Lithuanian animation industry. *Oeconomia Copernicana*, 8(3), 433–446. doi: 10.24136/oc.v8i3.27

Contact to corresponding author: tomas.mitkus@vgtu.lt, Department of International Economics and Business Management, Faculty of Business Management, Vilnius Gediminas Technical University, Saulėtekio al. 11, 10223 Vilnius, Lithuania

Received: 18 January 2017; Revised: 12 June 2017; Accepted: 25 June 2017

Tomas Mitkus

Vilnius Gediminas Technical University, Lithuania

Dimitrios I. Maditinos

Eastern Macedonia & Thrace Institute of Technology, Greece

**Analysis of state aid policy to stimulate innovation
and internationalization in Lithuanian animation industry**

JEL Classification: *M16; F23; L82*

Keywords: *creative industries; animation; internationalization; film industry; management*

Abstract

Research background: In order to achieve systematic development and growth of creative industries, instead of its being a random process, effective cultural policy tools need to be implemented. This task is greatly burdened by the fact that creative industries are a heterogeneous concept. Evidence suggests that indirect state aid is one of the most effective ways to stimulate growth and development of audiovisual segment. Lithuanian indirect state aid case suggests that there is still a great deal of confusion and misconception with the implementation and exploitation of this tool.

Purpose of the article: To analyze how effectively indirect state aid is constructed to stimulate growth and development of the Lithuanian animation industry.

Methods: This paper uses two methods to gather data. The first one is a quantitative questionnaire design to evaluate the overall situation of Lithuanian animation industry. The second method involves qualitative semi-structured interviews to collect specific data about Lithuanian film tax incentive from representatives of government institutions that administer local fiscal incentive scheme and representatives of audiovisual industries.

Findings & Value added: Results show that although Lithuanian film tax incentive can be considered as a successful cultural policy tool that brought a noticeable inward investment to the local film industry and economy in general, it had no positive effect on the local animation industry. The gathered evidence suggests that indirect aid tool should be constructed with more of surgical precision for each industry, rather than a fit-for-all cultural policy tool.

Introduction

In this paper, the authors attempt to give an overall account of the indirect state aid tool, which is used to stimulate and increase innovation and internationalization in audiovisual industries, and in the broader sense — creative industries, over the past decade. From Europe 2020 strategy (2010) and Creative Europe (2009) programme to UNESCO (2009), UNCTAD (2008) and WIPO (2015) — all research on creative industries show evidence that this creative sector is still untapped and undeveloped. Today there are no more discussions on the topic whether creative industries can provide economic input to any country beyond cultural benefits. As WIPO (2015:7) notes, “the term “creative economy” has itself come to symbolize a new, global awareness of the role of creativity and innovation, (...) and their contribution to economic, social, and cultural development”. Therefore, the last decade was all about developing feasible tools that could achieve systematic growth and development of creative industries.

And this task is not that easy. In most general descriptions, creative industries are defined as a group of industries that use creativity to produce product or service that would contain cultural value. But in this paper, the authors bring focus to the fact that creative industry is heterogeneous, therefore, the tools that would be universally effective between such different creative industries segments like advertising, architecture, crafts, design (product, graphic and fashion design) film, TV, radio, publishing and etc. come with natural difficulty.

However, one of cultural policy tools has proven to be relatively successful with the task of supporting systematic development and growth of some creative industries segments. That tool is fiscal incentive schemes (i.e. tax shelters, tax credits or rebates). This type of state aid becomes increasingly popular around the globe in the past few years. Yet, today this aid is mostly used to stimulate audiovisual industries (film, TV, animation and in some cases — video games industries).

On the European scale fiscal incentives have proven to be effective cultural policy tool to reach higher growth rates, as oppose to countries that have not yet implemented any type of fiscal incentives (Olsberg & Barnes,

2014). Thus, evidence suggests that indirect state aid helps to sustain growth and increase economic output from audiovisual industries. However, European Commission (EC, 2013) states that most members of the EU cannot leave audiovisual industries to the market, because many of European audiovisual projects would not have been made simply for reasons of high investment required and the limited national audiences. Therefore, indirect state aid gives film producers a competitive edge in local and international market, as well stimulates the development of the local permanent pool of human skills. Therefore, cultural policy and tax policy are becoming more and more intertwined (Schuster, 2006).

The Authors of this paper do not aim to introduce an additional fiscal incentives theoretical framework, or to argue which of indirect aid types is superior. Rather, this paper aims to identify specific challenges that need to be address when constructing state aid mechanism to developed and sustain growth of local animation industry. Authors argue that, although there are always some local market specific challenges, there are also some universal elements that need to be implemented if fiscal insensitive is expected to improve the overall quality and quantity of productions. Such insights can be used to inform policymakers how to develop the most effective fiscal incentives schemes that promote development and growth of creative profile enterprises. And on the other hand, how to avoid pitfalls when constructing state aid mechanism that covers several industries?

This paper is structured as follows: the Authors firstly briefly introduce to the internationalization phenomenon in creative industries and why indirect state aid is such a lucrative allurements. Then, the Authors examine how audiovisual aid policy has evolved from cultural protectionism to state intervention on economic grounds in Europe. Secondly, an outline of research on Lithuanian animation industry and its relationship with the indirect state aid mechanism is presented. Lastly, the Authors conclude with a discussion of how the fiscal incentives schemes could be updated, expanded and modified to achieve systematic development of the animation industries.

Literature review

Indirect state aid is not a new phenomenon. The Canadian government had experimented with fiscal incentives for film and TV industries as early as 1974 (Morawetz *et al.*, 2007). In USA, Louisiana passed the tax credit scheme in 1992 (Grand, 2006), and by 2016, thirty-seven states offered some form of film and television production incentives (NCSL, 2016).

As at March 31st, 2017 there are a total of 22 European countries that could be identified using fiscal incentives schemes to support their audiovisual industries (Olsberg & Barnes, 2014; FNE, 2017). Furthermore, 10 schemes have been introduced in last four years. Therefore, there is a clear trend in continental cultural policy that recognises economic and cultural benefits of this support policy towards creative industries. It is worth mentioning that increased production scale and scope have a positive correlation with creativity and innovation (Crane, 2014).

Therefore, fiscal incentive schemes are used by government bodies as a tool to stimulate growth, or at the minimum, support creative profile enterprises within a nation. However, it is important to note that in all European countries there is also direct funding for creative projects (Olsberg & Barnes, 2014). Yet, the reason why indirect state aid is such lucrative bait in global audiovisual industries is that it provides “soft money” to cover production budget expenses. The term “soft money” is used to describe assistance or investment that offsets the cost of film production. Thus, with the help of fiscal incentives film producers can achieve bigger production scope without increasing the risk. As Lorenzen (2007) notes, majority of international audiovisual productions are designed to take full advantage of fiscal incentives schemes, as opposed to only few that are driven purely by artistic reasons. Even co-production is perceived mainly as a tool to gather a bigger budget (de la Garza, 2016; Caldwell, 2008). Therefore, modern global audiovisual industries are greatly affected by all type of “runaway productions” to foreign locations with tax incentives (Lorenzen, 2007; Yoon & Malecki, 2009).

Of course, there are other reasons why fiscal incentives have become so important in the global market of audiovisual industries. One of those reasons is that all creative production is project-based, and all crew members work on freelance basis (Davenport, 2006). Therefore, this provides producers with a possibility to construct any new project in the most economically-sounded way from grounds up, and to reduce any expenses involving downtime. Furthermore, this means that in most cases internationalisation of creative project does not equal more expenses, but quite the opposite — a reduction of financial risk.

However, in many cases international operations are only the way to gain ground for return on investment. Yet, when analysing internationalization in creative industries there is a necessity to explore and clearly define the process. For enterprises in creative industries, internationalisation is not always associated with export. As mentioned above, project-based activity in creative industries forged a comfortable environment for internationalisation within the production process. Internationalization in creative indus-

tries, excluding export, can be broken down to four types: (a) foreign direct investment in the local industry, (b) outsourcing (to foreign countries), (c) (international) co-production, and (d) international company. In addition, because creative industries use project-based form, internationalization (international co-production and outsourcing) of cultural product makes sense economically and creatively.

Thus, creative project production is not only easy to internationalise, but in many cases producers are more than willing to go to location where they can obtain “soft money”. This, naturally, motivates government bodies to modify their cultural policy in order to exploit this trend and to attract inward foreign direct investment to the industry. Thus, various fiscal incentive schemes have been introduced to support development and growth of creative industries in Europe, particularly audiovisual industries, since the late 2000s.

It is important to notice that in Europe these schemes were introduced not for solely economic reasons. In Europe there is a strong belief that audiovisual products, particularly films, play an important role in shaping European identities (European Commission, 2013). Therefore, the state aid to support cultural activities had existed before there was any evidence that creative industries could become an economic powerhouse that bring substantial economic benefits to the local economy (Mitkus, 2011; Mitkus & Nedzinskaite-Mitke, 2015). Furthermore, for decades it was a matter of prestige to sustain national audiovisual industry with state aid, even if its production could not bring revenue that would cover expenses or achieve artistically distinguished production.

Therefore, although there are strong cultural and economic reasons to stimulate growth of creative industries with direct and indirect state aid, that also means that competition in the market may be distorted. In the EU all support mechanisms have to comply with the European law that regulates state aid to ensure fair competition in the union (EU Regulations, 2015). Therefore, any indirect state aid by member states, targeted to support creative projects, has to follow those restrictions. “Cultural test” is a safeguard to insure that fiscal incentives would be used to support creative work and promote culture, rather than aid audiovisual production that has only commercial applications (like production of video advertising, music clip, pornography and etc.). And, although cultural test application is logical in terms to use state aid only to support a production of cultural products, it also has raised issues in practice (European Commission, 2013).

The key issue with cultural test is its duality. As mentioned above, cultural test is a sentinel that ensures that aid will be used only for production

that is perceived as culturally valuable, but at the same time the goal of the fiscal insensitive is to attract inwards investment to the local industry. Therefore, if a cultural test is designed too strictly, it will beat the purpose of aid as allurements. On the other hand, if cultural test is designed too loosely, state aid could be used for not cultural production or even not be comparable with the EU state aid rules.

The UK tax incentive can illustrate the former case, where the industry and the government came to conclusion that cultural test is too strict and needed to be modified so that better results would be achieved. In 2014 the UK modified cultural test so it would put emphasis on British creators, rather than focus on British narrative to pass the cultural test. Thus, those changes have been made to loosen up a little bit the rules, so it would help to encourage more inward investment to the UK film industry (BBC, 2013). However, it is too early to determine what impact the changes of fiscal incentive scheme had on the British audiovisual industry, as data collecting process is still going on, but early evidence suggests that it is mostly positive (BFI, 2016). However, industry-specific literature claims that the UK's tax relief scheme is the major reason for impressive boost that industry has received in last few years (Ritman, 2017).

The report on the impact analysis of fiscal incentive schemes supporting film and audiovisual production in Europe (Olsberg & Barnes, 2014, p. 3) states that there are three main types of incentive structures commonly used in Europe — (a) tax shelters, (b) rebates and (c) tax credits. For the purpose of this paper, it is enough to conclude that every government body is capable of determining which type of fiscal incentive scheme is best suited for the purpose of stimulating audiovisual industries. Furthermore, once the type of indirect state aid is chosen, in one way or another, evidence will be gathered to determine if it is sufficient, or any type of modifying is required. Therefore, The Authors argue that it is not the type of fiscal incentive scheme that makes or breaks indirect state aid, but the way it is tailored to stimulate industry. For example in the USA, since 2009, 10 states have abandoned film incentive programs, as many studies have estimated that the costs of this aid outweighs the benefits (Luther, 2010; FNE, 2017).

However, it is paramount to look at fiscal incentives schemes in audiovisual industries today as a survival tool, not as an innovative way to get ahead in the global competition. Adkisson (2013) argues that the incentive trend should be perceived as a zero-sum game. Therefore, state aid can help to stimulate industry only if it is in harmony with other elements that are perceived as in demand by the global market. In other words, fiscal incentives schemes do not give a competitive edge for a country anymore, but rather allow for staying in the global competition.

The Authors argue that although, there is a clear evidence to perceive indirect state aid as a very effective tool to increase development and growth of audiovisual industries, the Lithuanian case demonstrates that the aim to generalize the scheme so it would fit different industries (that are at different level of maturity and development) may be a flawed strategy on the account of policymakers. However, indirect state aid is designed to provide competitive edge in the global market to the local enterprise, and cannot be perceived as an ailment. Thus, there are natural limitations to modification of this particular cultural policy tool.

Research methodology

Two methods to gather data were applied in this study. First one is quantitative questionnaire design to gather basic data about animation studios operating in Lithuanian. The second method involves qualitative semi-structured interviews, which were carried out with (1) representative of the Lithuanian Film Centre, (2) prominent film industry representative that used to be one of key lobbyist for this cultural policy tool implementation, and would regularly use Lithuanian film tax incentive, and finally, (3) representatives of three biggest animation studios in Lithuania.

For the quantitative questionnaire, a list of animation organisations was compiled using partial lists available in government agencies, industry associations, specialized institutes, etc. The authors identified 24 animation studios in Lithuania. A letter was sent by e-mail to all identified 24 animation firms inviting them to participate in the study to provide data about national animation industry. Out of those 24 studios, 6 studios verbally informed the Authors that they refused to participate in the research for various reasons. Therefore, eighteen animation studios were investigated in this research (75% of active animation enterprises in Lithuania).

A structured questionnaire with 46 questions and one extra section for comments at the end was posted in the specific internet platform. The questions were formulated to be incoherence with EU Europe 2020 strategy (2010), Creative Europe programme goals (2009), Lithuanian Republic Ministry of Culture Policy Guideline (2007) and Lithuanian Creative Industry Policy Guidelines for 2016–2020 timeframe (2015). The main objective of the questionnaire was to gather all-round information about animation industry for the first time in modern Lithuanian history.

However, this paper only analyses collected data relevant to the industry's internationalization process. Thus, other collected data about preferred animation techniques, artistic achievements in national or international

levels, innovation processes within the industry, perception of national academic level and so on, will not be addressed in this paper.

For the semi-structured interview that followed quantitative questionnaire, the most economically developed Lithuanian animation studios were selected. The sample pool of animation studios representatives is small, because since Lithuanian fiscal incentive scheme was introduced at the beginning of 2014, not even a single animation project has used the opportunity to acquire indirect state aid (LKC, 2017). Therefore, this paper focuses only on the biggest local animation studios with the record of international operations.

To identify these studios public internet platform “www.rekvizitai.lt” were used. This platform provides various information about officially registered Lithuanian enterprises, including, but not limiting to, annual turnover, number of employees and etc. Thus, studios with the biggest turnover were contacted to provide their perception and evaluation of national indirect state aid.

Findings

The data collected from conducted questionnaire revealed that 61% of Lithuanian animation studios at some point in their lifetime executed international operations. Furthermore, as many as 72% indicated that their studio has at least once delegated their representative to international animation industry’s event such as “Annecy International Animated Film Festival and Market” or “Cartoon Forum”. Thus, even those animation studios that have not yet executed any international operations are investing in international networking. Further on, the respondents were given single-answer Likert scale question, about how strongly they agree with statement that “participating in international industry events is vital to gather knowledge and skills needed to produce high quality animation project”. 50% of respondents indicated that they “strongly agree”; 28% of respondents indicated that they “more agree that disagree”; 11% of respondents stated that they “neither agree, nor disagree”; and the last two answers on the Likert scale (“more disagree, that agree” and “strongly disagree”) gathered 5.5% responses each.

However, the data collected from conducted qualitative semi-structured interviews revealed that at the moment there is a desynchronization between cultural policies that regulates indirect state aid structure and the industry. The representative of Lithuanian Film Centre stated that overall Lithuanian film tax incentive can be evaluated as successfully implemented

cultural policy tool. This statement is supported by statistics — 41 audio-visual project was produced with the help of 4.7 million Euros gathered through indirect state aid, starting fiscal incentive implementation in 2014 (LKC, 2017). And with the help of this scheme, 23.5 million Euros in total were invested in Lithuania from abroad.

Yet, the situation of the animation industry is somewhat different. As the interviewee noticed, there are quite a few reasons for animation industry's inaction and generalisation of the situation in the animation industry difficult to reach. But in the end, it is an animation enterprise's call to use or not to use this scheme to acquire soft money for they projects.

The interviewed representative from the Lithuanian film industry expressed strong belief that the Lithuanian film industry would not be able to compete on the international market without indirect state aid. Thus, because fiscal scheme producers were able to lure inward investment that in some cases even exceed annual direct state aid budget.

However, the film industry representative has noticed that it took time for the industry to understand the scheme, and it was even harder to prove that this scheme is beneficial to the business sector as well¹. But as of 2017 situation has improved greatly. After three years, there are increased competences within the industry, established networking with the business sector, and even data that prove how this indirect state aid is beneficial to the local industry and economy. Therefore, as film industry representative sums up: “this incentive helped for the (film) industry to find business sector and *vice versa*”.

However, when animation industry representatives were asked to share their perception of the film tax incentive, they all agreed that at this point the structure of the scheme is simply not very attractive. Most of the representatives in some form indicated that they did not fully comprehend how this scheme worked and at that point they did not feel that investment in better understanding would be beneficial for them.

When asked to indicate the key reasons for such a poor film tax incentive application for animation industry, a couple of problems were presented. The first key issue is that the animation industry in Lithuania is much less developed than the film industry. It still lacks resources and competences to be able to seriously compete on global market. And because of the structure of the scheme, organisations in animation industry find themselves in a situation in which it is very hard to pass cultural and production requirements of fiscal incentive. And, as one of the representatives stated:

¹ Lithuania is using “tax shelter” type of fiscal incentive. Therefore, to receive aid Lithuanian producers need to secure a “donor” from local business sector.

“the procedure is too complex and requires too much extra work. Especially, in comparison to the amount of soft money they can acquire”.

The second reason is the lack of direct aid to Lithuanian animation projects. As one representative pointed out, the fact that the Lithuanian Film Centre has been continually refusing to finance animation feature film projects is handicapping the whole industry. And that, in turn, results in reluctance to try film tax incentive.

Discussion

The study shows that Lithuanian animation industry is in quite a conundrum. The evidence gathered from quantitative questionnaire shows that more than half of animation industry representatives actively operate internationally, and around $\frac{3}{4}$ of the respondents indicated that representatives of their animation studios participate in international industry’s networking events. This suggests that internationalisation status of the company is generally pursued in the industry. This premise is supported by the evidence that shows that more than half of the representatives “strongly agree” and a quarter “more agree that disagree” with the statement that internationalisation is directly linked with the process that is needed to obtain skills and knowledge required to produce animation project that would be perceived globally as of high quality.

As data from interviews demonstrates, the Lithuanian film tax incentive is perceived very differently among animation and film industries. Representatives of the Lithuanian Film Centre and the film industry perceive the Lithuanian film tax incentive as a very successful tool to stimulate local audiovisual industries. Data about inward investments also supports this positive evaluation of this cultural policy tool. Thus, there is clear evidence that a film tax incentive scheme can stimulate at least the film industry in Lithuania. Therefore, the question is if film tax incentive scheme is ill-structured when it comes to stimulate animation industry or if the local animation industry is not developed enough to be able to use this type of aid to stimulate its growth.

As data from qualitative semi-structured interviews suggests, the key problem is somewhere in between. By all accounts, the local animation industry does not have the capacity, labour, skills or for that matter, sufficient funds to produce animation feature film. Although, animation industry representatives indicate that from their point of view the principal blame for this situation should be put on the institution governing the direct state aid process.

Evidence from literature review and from the Lithuanian film industry case study suggest that indirect state aid is a very valuable tool to stimulate growth and development of audiovisual industries. Yet, in order for it to be affective a few conditions need to be met. The first condition is the maturity of the industry. If the industry is lacking recourses to tackle bigger scope projects, no indirect state aid scheme will lure inward investment into the local market. However, this generalization can be a double-edged sword. The indirect state aid purpose is to stimulate growth and development of the industry. Therefore, if this cultural policy tool were to be implemented only if industry met “maturity” criteria, it could end up in a vicious cycle.

That brings us to the second condition. The design of indirect state aid scheme needs to be constructed with surgical precision. Not only does the scheme need to be attractive to local and foreign producer economically, but it also has to be easily understandable and administrative. Evidence from interviews suggests that because film industry’s representatives participated in the process when this cultural policy tool was constructed and implemented, they instantly had a clear understanding of the scheme and were able to explain the benefits of the scheme to business sector with relative ease.

Conclusions

Fiscal incentives schemes are gaining in popularity among countries and schemes are slowly implemented around the globe. Literature review also indicated that there is a trend for modifications where government bodies in charge of cultural policy move the emphasis of cultural test from the local narrative to the local high-end creative labor.

Indirect state aid cultural policy tool needs to be carefully tailored to achieve economic and cultural benefits. As evidence from the case of Lithuanian film and animation industries analysis shows, the fiscal incentive scheme can have very different effect when the difference of industries’ development is not taken into account.

Although, evidence collected from the questionnaire suggests that animation industry is actively conducting international operations and perceive market as a global phenomenon. Thus, indirect state aid should be a very important tool to increase competitive stand in global market. However, statistical data and semi-structured interview revealed that film tax incentive is not very well understood among animation industry’s representatives. Thus, it is not perceived as a tool in the global market, or to gain soft money to produce local animation projects.

The Lithuanian animation industry's case study raises a question about the concept of the indirect state aid, namely whether the fiscal incentive should be implemented only when the industry reaches some sort of maturity level so it could successfully exploit this aid or if it be implemented to increase the rate of industry's growth and development because the industry is not mature yet to compete in the global market?

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