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<sup>1</sup>B. Yermekbayeva, <sup>2</sup>B. Stojanović, <sup>3</sup>Zh. Kazbekova<sup>1</sup>High School of Economics and Business, Al-Farabi Kazakh National University, Almaty, Kazakhstan<sup>2</sup>Faculty of Economics, University of Niš, Trg Kralja Alaksandra 11, 18000 Niš, Serbia<sup>3</sup>High School of Economics and Business, Al-Farabi Kazakh National University, Almaty, Kazakhstan

E-mail: zhanat\_kazbekova@mail.ru

## State Support of Small and Medium Business: EU Experience and Policy in the Republic of Kazakhstan

**Abstract.** Development of small and medium-sized enterprises (SMEs) as a key factor of country's economic development is considered. The role of SMEs, indicators of their development in EU countries are shown, main directions of EU support to SMEs, their role and place in Strategy «Europe 2020» and main types of State Aid for SMEs in European countries are considered.

Development of small and medium business (SMB) in Kazakhstan, its role in the economy and in state development strategies is analyzed, instruments and directions of development are given.

**Key words:** Small and medium-sized enterprises (SMEs) support to SMEs, strategies of development, State Aid for SMEs, development programs, small and medium business (SMB) taxation, small and medium business (SMB) crediting.

### Introduction

Small and medium-sized enterprises (SMEs) are recognized as drivers of economic development. The analysis of the level of development of SMEs and entrepreneurship shows that this sector is the most vital and efficient part of the economy. It has an important role in implementing structural reforms, particularly in the function of job creation and growth of the overall economy. Potential investments in establishment of new companies are primarily motivated by business conditions, business climate and business environment that exist in the reality of countries. Stimulant character of the tax system with the lowest tax rate is desirable. Adopting of appropriate strategies and innovating of legislation indicates the awareness of the importance of small and medium enterprises.

### Methods

The global economic crisis has shown that SMEs are the most sensitive to changes in business environment. However, crisis had a negative impact on the competitiveness of SMEs and contributed the downfall of their liquidity, innovation and investment. To find the exit strategy, some SMEs have to establish the cooperation with mul-

tinational companies and clusters. More consistent institutional support contributes to improving international visibility and competitiveness of their products or services.

Through the analysis of the insufficient level of knowledge and skills, the gap between financial needs and existing financial instruments, regional disparities in development, insufficient use of new technology and innovation, attention is paid to significant source of state support, directed to economy strengthening and its competitiveness increasing.

### Main body

#### EU support to SMEs

According to the participation of small and medium enterprises in total employment and added value, the data indicate a significant level of activity and efficiency of small and medium enterprises in European Union (EU). Namely, the participation in the value added is 57.9% (EU average percent). Lower level of activity of small and medium enterprises in the some European countries is attributed to the following problems: insufficient level of knowledge and skills, the gap between financial needs and existing financial instruments, regional disparities in development, insufficient use of new technology

and innovation, inadequate representation of the interests of SMEs.

European Commission program aimed at supporting economic competitiveness and innovation (CIP) should provide companies with a somewhat easier access to funding, better business conditions, better access to information, and greater international competitiveness. This program has established also a standardized model of business services and consequently has improved the quality of products and increasing capacity of SMEs.

Since the SME sector is the biggest contributor to economic development, reducing unemployment and balancing regional development, governments need to provide it with support through various financing programs and continually encourage innovations. It is a prerequisite for creation of competitive and export-oriented SMEs.

All EU member states have responded to the call for more investment in innovation. For this purpose, they submitted even 455 programs. EU investment in innovation for the period 2007-2013 amount more than 85 billion euros. By adoption of the national strategies of development of competitive and innovative small and medium enterprises, governments have shown willingness to deal with problems of innovativeness and international competitiveness of SMEs according to standards and with the assistance of the EU. The Strategies are in line with the *European Charter for Small Enterprises* and *The Small Enterprises for Europe Act* [1]. It is a strategic document for creates development policy for small and medium enterprises and entrepreneurship who consistently and comprehensively defines the basic priorities and ways of their realization. As was made in late 2008, full implementation of this Strategy is followed starting from 2009. Its aim is not only to present the current situation, but also to predict the most important measures to satisfy the needs of entrepreneurs and to allow such a development of SMEs to become a key lever of international competitiveness and economic development. In addition, the successful implementation of this Strategy should contribute to establishing a number of new companies, growing faster micro-enterprises in SMEs, higher rate of survival in their first years of operations and their faster growth and development through mutual cooperation and networking in clusters (OECD, 2009).

To improve the competitiveness and innovativeness of SMEs, as well as the recovery of economy from the global economic crisis consequences, the governments should achieve two main goals:

1) Creating a standardized model of services and improvement of infrastructure to business support in order to increase the number of new small and medium-sized enterprises, as well as support their survival and competitiveness.

2) Increasing of innovation and competitiveness through capacity building of government institutions and specialized organizations to support innovation in business. This activity is aligned with the Strategy „Europe 2020«, which refers to promoting the improvement of conditions for innovation in small enterprises that are one of the key generators of employment and economic growth [2]. Promotion of innovativeness and competitiveness of SMEs provides that for achieving the goals as follow:

- Improving the capacity of government institutions to develop and coordinate policies affecting the competitiveness and innovation of enterprises,
- Improving the capacity of organizations to support innovation in business,
- Increasing the availability of business information on web portals,
- Overcoming the current obstacles faced by small and medium enterprises that seek to realize their innovative potential by developing new or improved programs and instruments,
- Increasing awareness of enterprise of the importance of innovation for productivity and profitability growth.

For the international competitiveness of SMEs, special significance have their technical competence. In fact, thanks to all the faster and wider implementation of new high technologies, SMEs could become leaders in technical innovation. To achieve this goal, the governments must:

- the reform both legislation and education to encourage the young entrepreneurs to improve the propulsion software in SMEs,
- support the electronic market research and the wider involvement of SMEs in the global e-business,
- reduce taxation those SMEs that apply and export of high technology, which implements the concept of e-government and promote enhancement of privacy protection.

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port contributes to improving international visibility and competitiveness of their products or services.

### **The Role of SMEs in Strategy «Europe 2020»**

Innovations are very important determinant of enterprise competitiveness and unemployment reduction. In order to maintain their competitiveness in target markets, companies need to be innovative.

Innovations require competitiveness. This means that the liberalization and competition in SMEs sector is beneficial for innovations. Innovations do not only involve new technologies or new products, but also new and smarter ways of conducting business, new management methods, new business systems or new services. Innovation does not only generate more jobs and profits, but also a «smart» development. Such development may include eco-innovations that improve the environment or social innovations, which provide similar opportunities to all. Innovations are not only based on higher production or higher sales but they also bring real improvements in quality of live. The keys of the innovation process are social and cultural environment. EU has adopted the Lisbon Agenda in response to the challenges of globalization, which established a set of ambitious objectives based on the idea that EU needs to promote innovation and research efforts in order to remain competitive. Focusing on innovations has led to the «birth» of a new generation of transnational cooperation programs, which primarily finance innovation processes.

Regardless of the current EU support, small and medium enterprises are understand the importance of innovation for business promotion and therefore are concerned with investing in it. EU average percent of gross domestic product allocated for scientific research and innovation is under 3 percent. The EU budget for the period 2014-2020 envisages 80 billion euros or 46 percent more for the costs of financing research and innovation. The new strategy named «Europe 2020» forecasts allocation of 3 percent of gross national product for research and development. The striving to improve conditions for private sector investments in research and development and developing new indicators for assessing innovativeness is especially stressed. It is emphasized in the aforementioned strategy that EU intends to increase the share of small and medium-sized companies in the global information and communication technology markets.

Strategy «Europe 2020» improves conditions for innovation in enterprises, by introducing a common patent institution for EU and by establishing a special court for patents, modernizing copyright and trademark system and increases the possibility

of intellectual property protection for small and medium enterprises. According to the aforementioned strategy in post world crisis times and the growing internationalization, SMEs must show a willingness to cooperate with other companies, unions, academics, NGOs and consumer associations in order to be able to respond to global challenges. Government has to be engaged in improving the business environment for SMEs by reducing management costs, promoting industrial clusters, and improving access to finance.

According the needs of small and medium enterprises, in the European Union was adopted document named «*Think Small First*»: *A Small Business Act for Europe* [3]. The results in the improvement of business conditions and creating an environment for the development of efficient and innovative small and medium enterprises might be desirably seen through the prism of fulfillment ten key principles of the Act in a particular country:

1. Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded;
2. Ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance;
3. Design rules according to the «Think Small First» principle;
4. Make public administrations responsive to SMEs' needs;
5. Adapt public policy tools to SME needs: facilitate SMEs' participation in public procurement and better use State Aid possibilities for SMEs;
6. Facilitate SMEs' access to finance and develop a legal and business environment supportive to timely payments in commercial transactions;
7. Help SMEs to benefit more from the opportunities offered by the Single Market
8. Promote the upgrading of skills in SMEs and all forms of innovation;
9. Enable SMEs to turn environmental challenges into opportunities;
10. Encourage and support SMEs to benefit from the growth of markets.

The results of the Report on the implementation of the European Charter, which includes evaluation of achieved results (1 to 5), indicate their overall improvement.

Successful moves in the reform of the tax system contribute to increasing of the attractiveness of starting a business. The attendance of practice of many developed countries which have lower tax rates for SMEs could be the target for underdeveloped economies in the future. These measures are often motivated by both efficiency and equity ob-

jectives. The efficiency objectives are based on the notion of failure, for example, due to higher compliance costs with regulations associated with diseconomies of scale and reduced access to financing, necessitating government policy. The equity objectives are in part motivated by lower profits earned by SMEs. Reducing of tax rates on corporate income could be a positive signal and encouragement for the domestic and foreign investors, or business starters. Efforts made in this field have resulted in increasing the transparency of the tax system and compliance with international standards.

#### State Aid for SMEs

At the level of the EU, the state aid granting is adequately regulated by a several regulations and rules. Due to the great importance of the issues, rules and regulations are constantly improving. In the European developing countries, which are not yet members of the EU, the requirements for developing a functional system of state aid control have emerged during the last decade (Stojanović et al, 2013). A long-time development of the system of state aid control of the EU has led to the establishment of appropriate patterns and rules in the allocation of each specific category of state aid. The main objective of the established rules is the greater expediency of the use of state aid granted, with the least possible distortion of competition in the market. The EU responds to this aim, which is often promoted by the phrase «less and better targeted state aid» [4].

The three main categories of state aid are horizontal, regional and sectoral state aid. Each of the main categories of state aid covers a wide range of objectives to which state aid is aimed. Given that state aid is aimed to a predetermined or known user in certain sectors and activities, this form of state aid is considered the least justified and carries the greatest risk of distortion of competition (Stojanović et al, 2013) [5]. Each type of state aid can be granted on one of three ways: as a state aid scheme, as an individual state aid and on an *ad hoc* basis.

*Horizontal state aid* is intended for all firms in an economy, not for selected and predetermined sectors and regions. It is considered as category of state aid that has the least destructive impact on the conditions of competition. State aid that is allocated horizontally to all sectors is less selective than other forms of state aid. Hence, the prevailing opinion is that the positive effects of horizontal state aid and its contribution to solving the market failure is much higher than its negative impact on competition. It is often argued that the horizontal state aid effectively correct the market failure and contributes to

the growth of social welfare (Kesner-Škreb, 2011, p. 1) [6]. These are the reasons why the authorities responsible for the state aid control are trying to impose rules that would redirect state aid from sectoral to horizontal. Any increase in the percentage share of horizontal state aid in the overall structure of aid is seen as a positive trend.

Horizontal state aid is aimed to: research and development (R&D); environmental protection; small and medium business enterprises (SMEs); rescue and restructuring of business entities in difficulty; employment; training; culture; provision of venture capital. The aim of regulation of horizontal state aid is a balance between the clearly specified objectives of great importance and danger that the state, in desire for its realization, distorts competition in the market. To achieve this goals, EU have specific regulation named General Block Exemption for several objectives. «General Block Exemption Regulation on state aids will simplify procedures and reduce costs. It will increase the aid intensity for SMEs and make it easier for SMEs to benefit from aid for training, research and development, environmental protection and other types of aid.» ([http://europa.eu/rapid/press-release\\_IP-08-1003\\_en.htm](http://europa.eu/rapid/press-release_IP-08-1003_en.htm)) [7].

Horizontal state aid is aimed to the objectives for which the clear benefits of state intervention are usually evident (Wishlade, Michie, 2009, p. 24) [8]. Nevertheless, the control of this type of state aid details the amount of state aid which can be approved, to which projects, under what conditions and what kind of development policies in particular should be supported in order to maximize the positive effects (Flam, 2008, p. 1) [9].

The fact that the horizontal state aid is not aimed to predetermined sectors or regions and its availability to a greater number of business entities make it less selective compared to the other two categories of state aid. Because of that, this category of aid has fewer possibilities for distortion of competition. Horizontal state aid is focused on the goals that are the backbone of sustainable economic development of the country (research, development and innovation, small and medium enterprises), or this type of aid is in the function of support and promotion often marginalized development goals (environment, education, employment of disadvantaged or disabled persons).

*Sectoral state aid* is intended to predetermined or known business entities in certain industries or sectors. Sectoral state aid carries a greater potential risk of distortion of competition in relation to the horizontal aid, due to the highly selective nature. Also, this form of state aid is not aimed at

correcting market failures. Very often, this type of aid only postpones the necessary radical changes and structural adjustments in certain sectors and industries. Therefore, the temporary nature of sectoral state aid is necessary for its positive effects. However, there is encouraging that this form of state aid is often transformed, under the pressure of users, from temporary into permanent. A particular danger is the allocation and concentrating sectoral state aid to a small number of companies. This method of its allocation easily leads to the risk of moral hazard and to a situation where companies expect help from the state whenever are in difficulties. This kind of aid can create an unnatural competitive advantage and put low-productivity sectors in a privileged position at the expense of other sectors of the economy. All above mentioned, in addition to a pronouncedly destructive effect on competition, may have a negative impact on the efficiency of the overall economy. There are some opinions that sectoral state aid, by favouring one, usually less efficient enterprises, reduces social welfare.

#### **Kazakhstani Strategies, policy and instruments**

Development of small and medium business (SMB) is the key goal of Strategy -2050. Necessity of creation of most favorable conditions for medium and small business development in Kazakhstan is a logical process caused by market relations development, directed to providing employment of population and forming of domestic commodities producers on a consumer goods market. Concern about constant development of entrepreneurs' work conditions has always been in focus of the Head of the State Nursultan Nazarbayev. In his Address to the nation on January 17, 2014 «Kazakhstan's way – 2050: common aim, common interests, common future» President of the country defined development of medium and small business as one of priority directions of Kazakhstan joining 30 most developed countries of the world. «Small and medium business development is the main tool for the industrial and social modernization of Kazakhstan in the 21<sup>st</sup> century. In this respect my position, as it is known, is well-defined, and I have expressed it many times. The greater the share of small-to-medium-sized businesses in our economy is, the more developed and sustainable Kazakhstan will be» [10].

Small and medium business in modern conditions becomes driving force of a new economy. In the world practice the level of small and medium business development is an indicator, which characterizes the success of the country, region or city.

Any state, if it aims to dynamic and harmonious development, must be competitive on the market, first of all must take care of entrepreneur initiative, especially in the economy. It is well-known that small and medium business development – it's an evidence of exertion of population's economic initiative. The subjects of small and medium business entrepreneurship are characterized by flexibility of activities conversion, freedom of economic maneuver, most fast turnover of current assets, short investment period. Small business in majority of cases is oriented on specific consumer, it can quickly fill niches in the sphere of production of common consumption goods, goods and services realization. That is why they can easily compete with monopolists. There are more than 800 thousand subjects of small and medium business in Kazakhstan, where 2.4 million of Kazakhstan people work. Production volume of this sector has raised for four years in 1.6 times and is more than 8.3 billion tenge [11].

State program of forced industrial – innovative development of the country for 2010 – 2014 years and Program «Road map of business 2020» are aimed to sustainable and balanced development of entrepreneurship activity in regions, above all in non-primary sectors of economy.

Program «Road map of business 2020» has been realized in four directions:

1. Support of new business initiatives;
2. Entrepreneurship sector recovery;
3. decrease of currency risks of entrepreneurs;
4. Strengthening of entrepreneurs potential.

Development of small and medium business in the Republic of Kazakhstan takes place mostly in intermediary sphere and branches requiring significant capital investments – trade, public catering, small automobile repair, farming, tourism, domestic services, beauty salons, pharmacies, etc. Share of SMB subjects in trade is more than 40 %, and in construction and industry – approximately 3% in each; while in USA and Great Britain they are 52%, in Japan – 53%, in Poland – 47%, in Turkey – 59% [12].

Small and medium business in our country most of all needs support of new business initiatives.

So far the sphere of innovative activity is weakly domesticated, there is no high technological business, without which Kazakhstan can come par with world developed countries robustly. It is very actual for Kazakhstan the development of small and medium business in the sphere of agricultural raw materials conversion, as agricultural raw materials in its specifics needs fast conversion (perishable, non-transportable).

Agricultural raw materials currently are being converted mostly by big companies, which are situated in isolation from raw zones. That is why it is advisable to increase amount of small enterprises converting agricultural raw materials in agricultural sector, rendering real assistance from the state, financial, first of all.

The Head of the State in his Address to the nation had voiced concrete ways of small and medium business problems solving. President noted: «The future lies in the creation of a network of new processing enterprises in the agricultural sector, mainly in the form of small and medium-sized businesses. In this area we should provide loans to business. Farmers should have direct access to long-term financing and markets without intermediaries. Also important is the creation of an effective system of guarantees and insurance of loans to rural producers».

As for industry, creating lots of small enterprises is necessary, first of all, in the sphere of production consumer goods.

Significant influence on development of small and medium business is rendered by financial stimulus of SMB support. They are: tax stimulus and SMB credit system.

Our country, according to world rating agencies' data, is considering as one of those with favorable for SMB climate. The example for this is functioning of special tax regime for SMB. Kazakhstan is one of the first countries in CIS had implemented such practice of taxation and, thereby, created particular regime for SMB subjects, which gave possibility to develop at the expense of minimum tax load.

With the purpose of further simplification of SMB taxation procedures some changes and additions had been introduced to the Tax Code of the Republic of Kazakhstan from 1 of January 2014.

According to introduced changes the marginal income of individual entrepreneurs, applying special tax regime on the Patent basis, can't be more than 300-time minimum wage size, determined by the Law about Republic Budget and functioning from the 1 of January of appropriate year.

There are following sums of marginal income for tax period for persons applying special tax regime on the base of simplified declaration in times to minimal wage size:

- for individual entrepreneurs: 1400-time minimum wage size, determined by the Law about Republic Budget and functioning from the 1 of January of appropriate year;

- for legal entities: 2800-time minimum wage size, determined by the Law about Republic

Budget and functioning from the 1 of January of appropriate year;

The minimum wage size for 2015 is determined as 21364 tenge.

For entrepreneurs, applying special tax regime on the base of simplified declaration the tax period from the 1 of January 2014 is a half of the year. That is why simplified declaration will be given once a half of the year instead of once a quarter. Changes, exempting individual entrepreneurs, applying special tax regime for subjects of small business, from giving the calculation of current payments on land tax, whereas earlier only individual entrepreneurs, applying special tax regime on the Patent basis, were exempted. According new Tax Code individual entrepreneurs, applying special tax regime for small business subjects, calculate land tax by land sections, used in their activity. Individual entrepreneurs, applying special tax regime for small business subjects (not only those on the Patent basis, but also on a simplified declaration basis) are exempted from current payments on property tax [13].

The evidence of unprecedented business support is a RK President's Decree Свидетельством of 27.02.14 г. «About cardinal measures on improvement conditions of entrepreneurial activity in the Republic of Kazakhstan» According to this Decree there are new possibilities for entrepreneurship development:

- from the April 2014 till 1 of January 2015 there was a moratorium on revisions of small and medium business subjects;

- President had charged the Government to take concrete measures for further improvement of business conducting conditions for Kazakhstan people;

- the practice of planned revisions will be cancelled, and there will be developed another system, objective, appropriate to world standards;

- the revision will be applied only to these entrepreneurs, who actually has high possibility of legislation offence.

As a result of introduces moratorium on revisions of SMB subjects the situation with revisions had cardinally changed. If in 2013 2/3 of revisions touched on exactly small entrepreneurship subjects, then in 2014 – oppositely 1/3.

The amount of active SMB subjects had changed positively in 2014. Only during 1 quarter of moratorium (April-June 2014) the amount of registered SMB subjects has raised on 15 606 units.

The increase of amount of active SMB subjects was for 99644 units bigger on 1.10.2014 г. in comparison with the amount on 1.10.2013, or on 13,2%. Thus,

only for a half year of moratorium on revisions the rate of active subjects of SMB increase overreached the rate of last 9 years almost 2-times (7,5%).

The amount of employed in SMB was of 146664 people on 1.07.2014 in comparison with the amount on 1.07.2013, or on 5,7%, wherein for the first quarter of 2014 (before the moratorium) there wasn't the increase of employed people in comparison with appropriate period of the previous year at all, there was the decrease on 0.1% oppositely.

Significant increase of production by SMB subjects was provided: thus the production volume of SMB subjects had increased for 37,8 % during the first half of 2014 in comparison with the appropriate period of 2013.

Productivity of labor in SMB for the first half of 2014 for one employed was 2,1 million tenge, whereas for the appropriate period of 2013 – 1,6 million tenge (increase for 31,3) [14].

The rise of all main indicators of SMB activity for the period of moratorium conducting was caused not only by fact growth of subjects and employed amount, production volume and productivity, but by legalization of SMB subjects, deducing from «shadow» this part of entrepreneurs, who hid the activity before. The evidence to this is a primary growth of active SMB subjects amount before registered SMB subjects amount. And this is not just increase of active SMB subjects, but legalization of workers in SMB, increase of officially employed in SMB (and well then legalization of wages of workers), legalization of production volumes of SMB, especially of those who worked for cash (in the sphere of foodstuffs, trade, services, etc. ).

Stimulation and support of SMB is especially actual, as it influences such spheres as:

- social sphere, the influence is in providing employment, creating new jobs, increasing percentage of economically active population, improving live conditions at the expense of entrepreneurial incomes, smoothing out development disproportions in wealth fare of different social groups of population;

- financial sphere, which is related to financial self-sufficiency of entrepreneurs and their family members, salary of workers;

- budget sphere, assuming tax and payments incomes to budget system, providing own income base of local budgets;

- economic-stimulating sphere, which is related to increase of owners amount, competitive selection of effective owners, who's further development depends on small business and creating competitive environment for other forms of business;

- innovative-investments sphere, which is very actual nowadays and related to development and implementation technological, technical and organizational innovations, indirect stimulation of production efficiency of big companies by new markets familiarization.

Development and normal functioning of SMB are also closely connected to crediting – main source of current assets replenishment. Subjects, working in trade, have biggest specific gravity of crediting by second level banks in Kazakhstan – they have 41 % of all subjects of SMB. They had got 38% of all credits from second level banks, when the production sector had got only 9%.

Accomplishing assignment of the Head of the State on realization of Kazakhstan development strategy on joining 30 world most developed countries, the government had developed key directions of the «Road map» of high-priority measures of social-economic policy for 2014.

One of the sources of stimulating sustainable economic development will be assignment of 1 trillion tenge from the National fund for 2014-2015 under the initiative of President Nazarbayev. 100 billion tenge, out of this 1 trillion – will be directed for SMB crediting in 2014. Such support from the state will certainly contribute to providing SMB projects by financial resources on available and long term basis. Out of 100 billion tenge – 50 % will be directed on refinancing of earlier given credits, 50 % – on new projects financing. Out from the new projects pool – 25 % will provide financing of food processing industry. Also before the 1st of July 2014 the financing of local projects in housing and utilities, road construction, repair and reconstruction of social objects will be increased at the expense of redistribution of sources of local executive bodies and over fulfillment of income part of local budgets [15].

Resources, gave out from National fund for SMB support, are the significant source of state support, directed to economy strengthening and its competitiveness increase.

From our point of view giving out 25 billion tenge for crediting projects on SMB development in food processing industry will give new stimulus to republic's agricultural sector development. It will increase agricultural demand, and as a result, agricultural sector will develop more intensively and will become more competitive.

### **Conclusion**

Role of small and medium business is indispensable in solving strong economic and social tasks. Small and medium business facilitates to «healthy» competitive environment, market equilibrium, new

jobs, middle class creating, different needs of population, and, finally, economic growth. During history of Kazakhstan independence important steps in attractive business-climate creating were done, and, as a result, there is a good international assessment and significant growth of small and medium business.

And for small and medium business would become an «engine» of the economy, and for its development not only in intermediary sphere and branches without significant investments, the state should further support small and medium business in complex, including its interests and using all available experience.

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