

Government debt of Kazakhstan under conditions of the global financial system's instability

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Abstract. The article discusses some approaches to improve the evaluation system of financial security and provides recommendations to ensure the financial security of Kazakhstan. The article discusses some approaches to improve the evaluation system of financial security, because the state cannot effectively implement its domestic and foreign policies in the interests of the state without in-depth analysis of factors affecting the economy. The paper offers recommendations to ensure the financial security of Kazakhstan.

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Introduction

This study aims at making recommendations to improve policies to ensure the financial security of the country with raw-material economy on the example of the Republic of Kazakhstan.

The financial and credit sphere of the Republic of Kazakhstan is the object of research.

The study was conducted using the method of comparative analysis, system and structure-tiered approach, methods of logical and statistical analysis.

Information base of the study consisted of the official data of the Agency for Statistics of the Republic of Kazakhstan, legal documents of the Ministry of Finance, National Bank of the Republic of Kazakhstan. In addition, information bases hosted at the international and domestic websites were used in the paper. The methodological framework of the study consisted of foreign and domestic scientists specializing in issues of economic security and foreign debt.

I. Characteristics of the gross external debt of Kazakhstan as the main item of the financial security.

The crisis period turned out to be quite difficult for Kazakhstan in terms of preserving economic stability and security. Restoring economic growth was mainly due to production growth in the extractive industries and the favorable situation on world markets of raw materials. Reduced prices for mineral resources found in the range of permissible values for Kazakhstan. The increase in production in the process industries was supported by the government economic programs.

However, government anti-crisis measures somewhat increased the budget risks, in particular, the level of budget deficit was increased. The budget deficit according to the results of the state budget

execution in 2010 in Kazakhstan, in fact, reached a level of 11% of the budget revenues. According to the Law of the Republic of Kazakhstan "On making amendments and addenda to the Law of the Republic of Kazakhstan "On Republican Budget for 2011-2013" in 2011 the threshold of the budget deficit was increased to 16.4% of the budget revenues, which amounted to about 4.8 billion USD [1].

National Bank of the Republic of Kazakhstan presents the following relative data on external debt of countries (Table 1).

Table 1 – Relative ratios of gross external debt of the Republic of Kazakhstan in 2010-2011

Indicators	2010	2011
1. Gross external debt per capita (USD, excluding intercompany indebtedness)	4 015.9	3 833.8
2. Ratio of gross external debt to GDP (%), incl. intercompany indebtedness)	81.7	66.6
3. Ratio of gross external debt to GDP (%), excl. intercompany indebtedness)	45.2	34.4
4. Ratio of gross external debt to export of goods and nonfactor services per annum (%), incl. intercompany indebtedness)	183.2	133.2
5. Ratio of gross external debt to export of goods and nonfactor services per annum (%), excl. intercompany indebtedness)	101.4	68.8
6. Ratio of payments to repay and service debt to export of goods and nonfactor services per annum (%), incl. intercompany indebtedness)	33.5	24.2
7. Ratio of payments to repay and service debt to export of goods and nonfactor services per annum (%), excl. intercompany indebtedness)	20.4	16.4
8. Ratio of interest rate payments to export of goods and nonfactor services per annum (%)	7.1	4.9
9. Ratio of international reserves to short-term external debt by original term	313.1	321.3
10. Ratio of international reserves to short-term external debt for the period remaining to maturity (Guidotti rule)	117.0	140.3

Source – National Bank of the Republic of Kazakhstan [2]

The external debt of the country is growing together with the budget deficit. According to the National Bank of RK the gross external debt (GED) of Kazakhstan according to the results of 2011 amounted to \$123.8 billion against \$113.2 billion at the end of 2009. Thus, the GED of the country

increased for two years by 11%. In particular, the public and publicly guaranteed external debt amounts to 5 492.6 million USD, publicly not guaranteed external debt - 123 847.8 million USD. During the crisis, the Government complained that the liabilities of the banking sector of Kazakhstan amounted to 42 billion dollars. However, by 2011 the level of liabilities of the banking sector fell to 18.8 billion dollars. It would seem that public external debt should be reduced, but it gradually increases to nearly 124 billion dollars; while the country's GDP is about 186 billion dollars.

As we can see according to the data in the table, in some cases intercompany debt is not taken into account. But, nevertheless, it is still burdensome on resources, on the population of Kazakhstan, as the increase in debt leads to an increase in service requiring the growth of raw material extraction, which is a non-renewable resource!

Currently, the country's external debt is about 70% of GDP, while the critical value is considered to be the level up to 50%! (Table 2).

Table 2 – Some parameters of the external and internal debt of RK in 2010 – 2011

N	Indicator	Threshold	2010	2011
1	Ratio of gross external debt to GDP in %	no more than 25-80	81.5	66.6
2	Ratio of external debt to export of goods and services in %	no more than 10-300	183.1	133.2
3	Ratio of payments for debt service to export of goods and services in %	up to 15-30	33.5	24.2
4	Ratio of publicly guaranteed and public debt to budget income in %	no more than 290	73	15
5	Ratio of publicly guaranteed and public debt to GDP	no more than 50-70%	15	3
6	Ratio publicly guaranteed and public debt service payments to the budget expenditure	no more than 20-30%	-	-
7	Ratio of public debt service payments to the budget income	no more than 10%	-	-
8	Ratio of external debt service payments to gross domestic product in %	-	14.9	12
9	Ratio of international reserves to total external debt in %	-	29.6	19.7
10	Ratio of international reserves to the volume of import of goods and services	Not less than three months of the import volume	1.28 (three month import volume of RK amounts to about 5.5)	7.5 billion – the volume of 3-month import 29 billion – the amount of gold and forex reserve
11	Ratio of international reserves to short-term external debt in %	no more than 100	314	305
12	Share of short-term debt in total external debt in %	no more than 50	7.6	7.3
13	Ratio of external debt to government expenditure in %	no more than 250-280	353	341
14	Ratio of external debt to government revenues	no more than 250	397	338
15	Gross external debt per capita in USD	-	7 242	7 427
16	Domestic debt to GDP ratio in %	no more than 30	7.74	9.6
17	Internal debt service payments in % to the budget	Up to 25	-	2.4
18	Share of external borrowing to cover budget deficit	Up to 30	-	

Source – National Bank and Ministry of Finance of RK [2]
Note - Thresholds are specified according to various sources including the IMF [3], S. Glazev [4]

Some authors suggest a threshold of up to 80%. But given the raw material orientation of our economy and its dependence on external factors, such a threshold is dangerous. GED per capita has grown significantly. If the gross external debt per capita

(excluding intercompany debt) increased from 387.1 USD in 2000 to 1019.4 USD in 2004, then by 2010 this figure amounted to more than 4000 USD per person when excluding the intercompany debt. The below table shows the indicators of external and internal debt of the Republic of Kazakhstan in 2010 and their thresholds, among which there are those not covered either by the National Bank or the Ministry of Finance of the Republic of Kazakhstan.

According to the data in the table the current state of country's external debt is on the verge of the greatest possible performance thresholds. These parameters are considered acceptable in the world for countries with an average level of per capita income, to which currently the Republic of Kazakhstan relates. However, given the dynamic growth of external debt per capita and the dependence of the national economy on various endogenous and exogenous factors, as well as the stronger role of the financial system and the raw-materials sector, the threshold values of the country's financial security indicators should be thoroughly examined and revised to tighten. It requires a more complete disclosure of the information on the financial system and the state budget.

II. Figures-indicators of the financial security level

The global financial crisis spurred the financial supervisory authorities of the republic to implement measures to prevent them. In this regard, the National Bank prepares an annual report on the financial stability of the republic, which reflects the major risks of the financial system, analyzes the macroeconomic situation and evaluates its stability. The report is quite detailed and contains almost all the figures - indicators of economic risk (risks). By the results of 2012 there is a decline in the significance of most risk factors that affect financial stability. In view of the situation of instability in the major economies of the world shows a significant increase in range of external risk factors, however, this figure estimated in the map of risk assessment does not exceed the threshold value, signaling a dangerous level of risk. Reduction of external liabilities of the banking system led to a reduction of debt burden, the risks of reserve adequacy and risks of profitability and capital adequacy. The favorable situation on world markets had a positive impact on the current account balance, but the significance of the risks associated with foreign economic activity remains relevant because of the high volatility in commodity markets.

The following figures-indicators of the level of financial security may be considered in addition to the above Table 2 to determine the instability of the system (Table 3)

Table 3 –Classification of figures-indicators that reflect the level of financial security

N	Figures-indicators	Thresholds for Kazakhstan
1 External figures-indicators of an international character		
1.1	Indices of global stock markets	↓
1.2	Indices of world commodity markets (the price of oil, metals, grains, etc.)	↑
1.3	Changes in global financial markets (exchange rate of euro, USD and other currencies against the national currency; interest rates in international financial markets; international financial institutions, etc.)	↓
2 Internal figures-indicators of financial security		
2.1 Indicators of economic growth		
2.1.1	GDP per capita in USD	↑
2.1.2	GDP growth (1.5 - 4% per year)	min 7%
2.2 Balance of payments		
2.2.1	Current balance	1% to GDP -1.5 billion USD*
2.2.2	Funding for the balance of payments	
2.2.3	The level of gold and forex reserves	The value of goods and services import for 6 months - the amount required to repay short-term debt (up to 1 year)
2.2.4	Export prices	not less than 80 USD per barrel (in 2012) Oil price not less than 60 USD per barrel for Russia*
2.2.5	The real effective exchange rate	147.5 (in 2012)
2.2.6	Capital outflow	≥ 50% of the current account of balance of payments Up to 8.3 billion USD for Russia*
2.2.7	The level of foreign investment in fixed assets to GDP, their structure	
2.3 Interest rates		
2.3.1	Real interest rate	4.4%* The increase in real interest rates often indicates reduction of liquidity in the financial system. According to Fisher, the real interest rate should be numerically equal to marginal productivity of capital. In Kazakhstan, it is more than 10%
2.3.2	The difference between the internal interest rate and the LIBOR rate	40 p.p.*
2.3.3	Ratio of loans rate to the rate on deposits	
2.4 Monetary indicators		
2.4.1	Rate of inflation (1-3%) (3-10%)	up to 5 %
2.4.2	The dynamics of internal credit in real terms	1.6%*
2.4.3	Money multiplier	3.24
2.4.4	The growth rate of deposits in real terms	
2.4.5	Ratio of money supply to gold and currency reserves	3.7*
2.4.6	Excess supply of money in real terms	2.2% GDP*
2.4.7	The level of money supply to GDP (Monetization - 40-50% of GDP)	70% to GDP
2.4.8	The index of exchange market pressure	1.7*
2.4.9	Ratio of M2X to M2	10%
2.4.10	Ratio of international reserves to M2	0.13
2.4.11	Ratio of M2X to M0	25%
2.5 Indicators of the state budget		
2.5.1	Deficit (surplus) of the state budget to GDP	Up to 3%
2.5.2	National Fund	min = GED service payments
2.6 Indicators of corruption		
2.6.1	Corruption perceptions index by Transparency International	4-5 points
2.6.2	The level of shadow economy to GDP	Up to 10%
2.7. Indicators of financial security of the financial sector		
2.7.1	Ratio of corporate sector credit services to its profits	Up to 15-20%
2.7.2	Ratio of external debt of the banking sector to the total equity capital of the banking system	20%
2.8 Indicators of financial security of the banking sector		
2.8.1	Ratio of banking sector assets to GDP	80-100%
2.8.2	Total foreign bank's position in relation to total equity of the banking system	up to 20%
2.8.3	Share of the loan portfolio in assets	More than 45%
2.8.4	Share of bad loans in the loan portfolio	Less than 10%
2.8.5	Return on equity	More than 15%
2.8.6	Return on assets	More than 1-2%
2.8.7	The level of concentration of the banking system	80/20
2.8.8	Ratio of interbank loans to liabilities	up to 25%
2.9 Indicators of financial security of the corporate sector		
2.9.1	Leverage	4%
2.9.2	Ratio of interest payments to cash flow	

*Source: [5]

III. Characteristics of some factors affecting the financial security of Kazakhstan

As Kazakhstan's economy considered being small raw materials-producing economy, the external factors affecting the level of financial security are independent and the impact on them is almost impossible. In the case of Kazakhstan they should be taken into account when building the economic strategy. As for the internal factors, the conditions of their change can be adjusted based on the given internal figures-indicators.

In world practice, there are examples where the level of GDP per capita is about 40 thousand USD per year. In Kazakhstan, on the basis of 2012 the level of GDP per capita amounted to about 11 thousand USD. For a developing economy - this is a good indicator, but the raw materials structure of GDP, dependent on the situation in the world commodity markets, should be taken into account. For such an economy the indicator of GED to GDP making around 80% - is quite high and therefore in an unstable world economic system the external borrowing should be limited to at least 50-60% of GDP.

Now the government is trying to increase not only external, but also internal debt. This is indicated by the budget deficit. To repay loans and cover the budget deficit, we need to "borrow" from the future generations and to use funds from the National Fund, but the President announced the integrity of the National Fund except as a one-time transfer to the budget. So, apparently, the issue of the national currency will become a necessity, a consequence of which is the inflation. The issue of paper money to cover the deficit and increase the credit resources leads to a depreciation of cash operating in the consumer market as a means of circulation, higher prices and lower welfare of those social groups whose incomes do not have time to rise following the increase in prices. Already, inflation pressure is quite noticeable. Thus, according to the National Bank the inflation rate in 2012 was formed at a rate of 6.0%. The increase in inflation was caused by rising prices of food products and paid services, increasing the price index in industry and cargo tariffs. Products in the Republic of Kazakhstan continue to increase in price.

Dependence of the country on the global price situation is reflected in the country's balance of payments. High prices for raw materials exported from Kazakhstan - oil, industrial metals and grain were the main catalysts for improving the trade balance. According to preliminary estimates of the NB RK the positive balance of payments of Kazakhstan in 2010 amounted to 4.735 billion USD, 92.25% higher than in 2009 - 2.463 billion USD. A

significant increase in the balance of payments surplus was formed due to the improvement of the current account. The current account of Kazakhstan in 2010 recorded a surplus at 4.93 billion USD instead of a deficit of 4.25 billion USD in 2009. The reason for this has been a significant increase in the 2010 of favorable balance of merchandise trade - by 91.4% to 29.01 billion USD against 15.16 billion USD in 2009.

The situation with the capital and financial transactions account in 2010 in Kazakhstan was not as rosy as the current account. According to preliminary estimates for this item of balance of payments was recorded outflow of foreign currency amounting to 0.2 billion USD. Which, of course, is not comparable with the influx of foreign currency for this item in 2009 - 6.71 billion USD.

The negative balance on financial account in 2010 is associated with substantial payments on foreign liabilities of banks and the real economy. Balance of payments on medium-and long-term investment amounted to 7.87 billion USD last year. The outflow of currency from the country on short-term borrowing was formed at a rate of 9.78 billion USD.

However, the load on the financial account of Kazakhstan for future periods decreased significantly due to the cancellation of debts of the banking sector in the amount of 11 billion USD and restructuring of the remainder of the debt.

It is worth noting another distinctive feature of the balance of payments of Kazakhstan in recent years. If in 2009 the inflow of investment into the country was mainly through the channel of direct investments - 10.5 billion USD, and the volume of portfolio investment was insignificant - 2.99 billion USD, in 2010 the picture was back to the other. The volume of direct investment amounted to only 1.25 billion USD, while the volume of portfolio investment rose to 8.32 billion USD.

This situation suggests that investors prefer to invest in Kazakhstan through the stock market, buying stocks and bonds of local issuers. This is a global trend, which, however, carries some risks. In the event of external shocks, portfolio investors may begin to withdraw their money, which will provoke fluctuations in currency and stock markets of Kazakhstan.

Index of real effective exchange rate at the end of June 2010 was 13.9% above the basic level (December 2000) and 13.3% of the level in December 2009, at the end of 2010 it became 8.3% and 7.8 % above, respectively. In 2011 the exchange rate of dollar was 146.6 KZT, but since 2012 there is a steady increase to 148.4 KZT per dollar. But overall

appreciation of KZT does not lead to a decrease in competitiveness of domestic producers.

If we consider the outflow of capital, which is reflected in the balance of payments, as the increase in foreign assets of residents of the country as a result of transactions with nonresidents, then in recent years more than 70% is provided by the growth in assets of the public sector, including government and National Bank, mainly due to the international reserves of National Bank and assets of the National Fund of Kazakhstan. The outflow of capital mainly related to the growth of assets of the public sector abroad, as a result of investment of funds from the National Fund of Kazakhstan in foreign assets. So, for the transactions of the public sector there has developed a net outflow of 5.8 billion USD in 2010 and 7.6 billion USD for the first 9 months of 2011 [6]. However, the outflow of capital confirms withdrawal of money from the national economy, where they could also be effectively used in accordance with the needs of the economy.

Given the peculiarities of the Kazakh economy development as raw materials-producing, the important role is played by the presence of fund for future generations - the National Fund. In times of crisis and post-crisis period, the existence of such a fund was a pillow of economic security for the country. Each year, the transfers to the national budget are made from the National Fund. In accordance with the concept, starting in 2011 in order to avoid volatility of guaranteed transfer volumes and to ensure an intense accumulation of the National Fund in the long term, the guaranteed transfer to the national budget is fixed in the absolute value of 8 billion USD. A minimum balance at the rate of 20% of the projected value of GDP at the end of the relevant financial year established to implement the savings function of the fund. In the event of failure of the National Fund for carrying out the guaranteed transfer due to the need to comply with the limit of minimum balance, the amount of the guaranteed transfer will be reduced by a corresponding amount. This measure has been included in order to prevent rapid "consumption" of assets of the National Fund.

By the beginning of 2012 the estimated total market value of the portfolio of the National Fund was approximately 69 billion USD. Investment income of the National Fund for 2010 amounted to approximately \$917 million, and since the beginning of creation - \$5.08 billion. A further diversification of the currency and instrumental structure of the Fund is planned in the framework of the development of the strategy of investing the assets of the National Fund. The opportunity to invest in countries with developing financial markets is considered at this stage. Since the National Trust is a "pillow of

economic security", its assets must exceed the sum of payments for external debt service.

The level of shadow economy has an important significance in ensuring the financial stability of the economy. According to official statistics, in 2008 in Kazakhstan there was more than 3 trillion KZT (at today's exchange rate - 20 billion USD) in the shadow turnover. In accordance with the data provided in the document, in 2009, according to the department, the size of the shadow economy was 19.5% of GDP, in 2010 - 20% of GDP.

It is difficult enough to reduce the size of the shadow economy by administrative methods. It is therefore necessary to create such conditions so that it would be more profitable for an entrepreneur to work in the formal sector of the economy and it would involve less cost and risk than if he worked informally. The shadow economy leads to a reduction in the tax base. As a consequence, the tax burden on the legal sector of the economy is increasing, its competitiveness is reducing. This, in turn, urges other economic institutions to withdraw into the shadows. The resource provision of corruption is enhanced that leads to an increase in its size. Redistribution of national income takes place in favor of some elite groups involved in the control of the informal sector.

Kazakhstan took the 105th place out of 178 in the index of corruption of the world prepared by Transparency International. In 2011 Kazakhstan was given 2.7 points from a possible ten. A year earlier, Kazakhstan also took the 120th place in the ranking of Transparency International. Among the CIS countries Kazakhstan and Moldova are in the lead on the list of this year, occupying the 105th place. Armenia (123rd place), Belarus (127th place), Ukraine and Azerbaijan (shared 134th place) are ahead of Russia. The highest score in the ranking of Transparency International was given to Denmark, New Zealand and Singapore - 9.3 points. Somalia took the last place in the ranking. It was given 1.1 points.[7-12] The rating is prepared by the Transparency International based on survey of experts and business representatives of 182 countries of the world [13].

Conclusion

Thus, at present the most important national interests of Kazakhstan concerning the financial sector may include:

- maintaining public expenditure in line with available resources;
- further expanding the National Fund and improving the system of effective management of its assets;
- providing targeted funding of government programs, primarily social, scientific and innovative

ones that ensure the increase in competitiveness of the economy;

- activating widespread investing in the sphere of science-based and high-tech industries from the business;
- creating the necessary conditions for development of entrepreneurship and free market competition;
- reducing the impacts of the global financial crises on the national economy;
- strengthening containment of inflation, and above all the price processes in the economy and maintaining a consistently high rate of national currency;
- opposing to the illegal export of capital abroad;
- attracting foreign investment (especially long-term in the manufacturing sector of the economy);
- building an effective enforcement mechanism to protect public finances from the impact of criminal processes and abuse;
- creating the regulatory framework to address corruption and reducing the shadow business as maximum possible.

Threats to the financial security of Kazakhstan may be divided into internal and external. The internal ones include: inefficient system of state financial control, low level of social orientation of economy, low level of the organization of financial security systems in commercial organizations, fall of the solvency of the population, low capacity of the financial system to ensure the manufacture of high-tech products competitive on world markets, inefficient tax policy, lack of effective protection from the pressure of lobby groups, high inflation characterized by low level of price regulation in highly-monopolized industries, low entrepreneurial activity, high-risk monetary and credit policy, inefficient privatization, instability and poor performance of many financial institutions, lack of integrity of the legal provision (including public regulation of financial markets), poor stock market, ineffective activity of the government bodies in the management of the financial system of the state (poor management, red tape, various economic crimes, etc.), "flight" of capital, etc.

The major causes of external threats to financial security include: the dependence of the Kazakh economy on the global situation on world commodity markets, the impact of domestic and foreign policy of other states on the foreign economic ties and relations, the growth of external financial debt of Kazakhstan, the excessive dependence of the economy of the country on foreign short-term speculative capital, etc.

In addition, under current conditions the following ways to strengthen the financial security of Kazakhstan should be taken into account:

2. establishing the limits of foreign participation in equity of domestic companies;
3. sectoral restrictions, i.e. restricting or prohibiting the access of foreign investment in the sectors recognized particularly important for the economic and socio-cultural development of the state;
4. requirements in the production, use of local ingredients, technology transfer, etc.;
5. development of effective systems to monitor the attraction and use of foreign borrowing.

One should also pay attention to the system of economic decision-making. In Kazakhstan, there has been formed a tripartite system of economic decision-making of national importance: the government which under the Constitution supervises and is responsible for the socio-economic situation in the country; the National Bank which regulates the monetary financial system and more recently the financial markets and the activities of financial institutions and "Samruk-Kazyna" public holding which regulates the activities of state investment institutions, public companies, as well as implements the economic policy of the state. Each of these parties pursues its goals and objectives. If on the one hand the Government is trying to stimulate the economy which requires financial resources that are distributed by the public holding from the state budget, and on the other – NB RK is trying to keep inflation as from the point of view of economic security, inflation should not exceed a certain threshold. A linkage between the activities of public bodies, structures and institutions is required. In this connection we can offer the creation of a public and governmental supervisory structure which would report directly to the President of RK, as well as to the general public. It is necessary to interact closely with the Audit Chamber of RK and other relevant agencies, such as the Security Council of the RK. The public and governmental supervisory organization and independent experts hired by it (auditors, experts) will directly supervise all levels of governmental

power and management with a view to ensuring financial and economic security by them. At the same time, it will report on its work both to the President of RK and to the general public (through media). *All this will validate the status of the public and governmental organization.* Information received by the public and governmental supervisory body should be regularly discussed in the media (television, radio, newspapers, magazines, anthologies, newsletters, etc.), i.e. actual *transparency* should be ensured by openness of the state bureaucracy. The main result of the proposed public and government supervisory body is to inform the President of RK and the public about the real state of the financial (economic) security in the country and the formation of a stable public opinion on the work of public bodies. One of the ways to improve public control is the use of *an independent audit* in its activities, as the auditors are qualified to audit complex financial systems. In Kazakhstan, in our opinion, the unification of efforts of public and audit control systems will not only solve the personnel problem of social control, but also give a fundamentally new effect in the control of public finances. Auditing organizations, having accumulated considerable experience in regular inspections and analysis of the solvency, financial stability, economic efficiency of various organizations and their associations, will be able to properly and timely notice certain trends and patterns in their activity, which is very important in preventing problems in the financial sector.

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