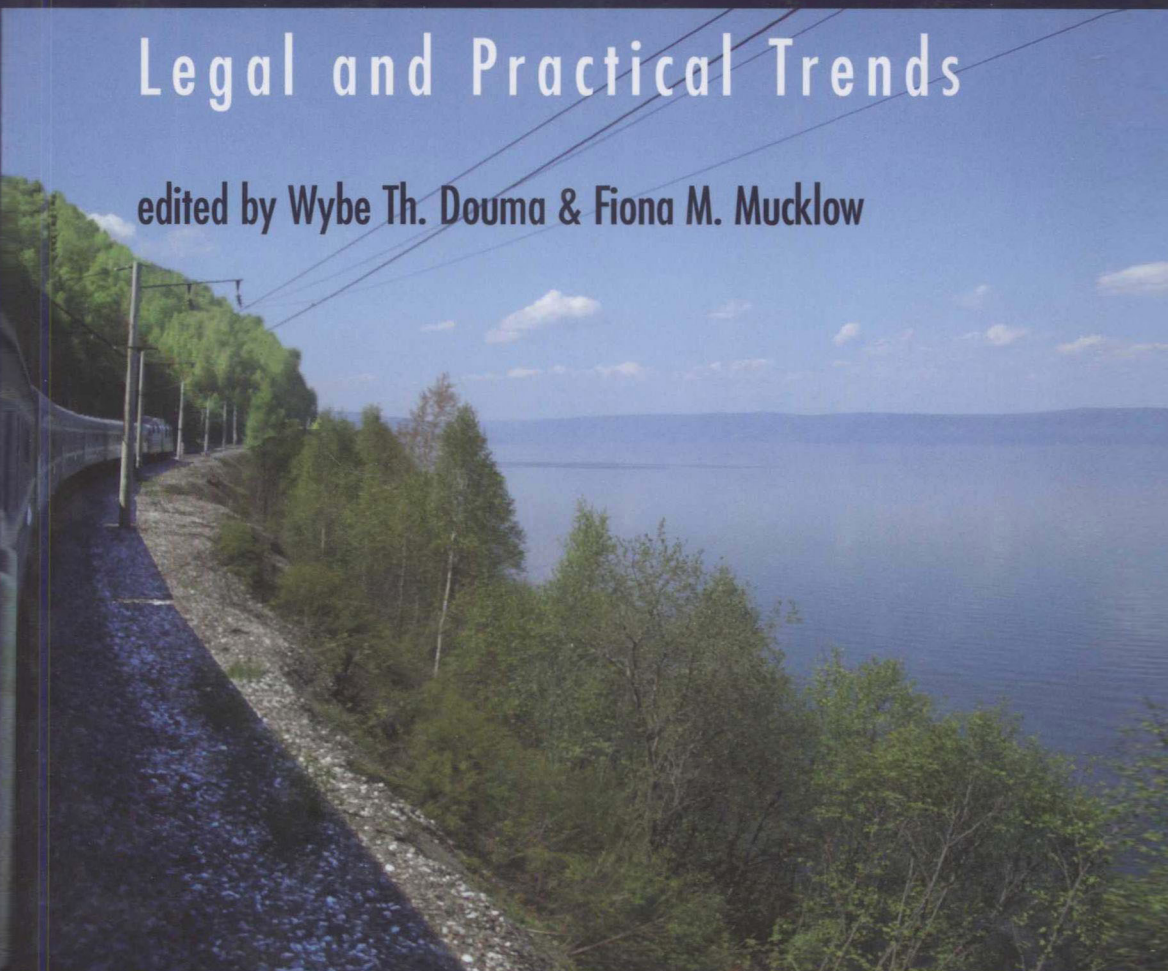


Environmental Finance and Socially Responsible Business in Russia

Legal and Practical Trends

edited by Wybe Th. Douma & Fiona M. Mucklow



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ENVIRONMENTAL FINANCE AND
SOCIALLY RESPONSIBLE BUSINESS IN RUSSIA
LEGAL AND PRACTICAL TRENDS

edited by

Wybe Th. DOUMA and Fiona M. MUCKLOW



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ENVIRONMENTAL FINANCE AND
SOCIALLY RESPONSIBLE BUSINESS IN RUSSIA

LEGAL AND PRACTICAL TRENDS

FOREWORD

We all have to look carefully at investment ideas, whether in good or difficult times. Corporations everywhere are under pressure to behave responsibly. Despite what some believe, the vast majority are naturally disposed to want to do that: it is in their longer term interests, and after all, who would of themselves wish to be irresponsible? But context determines behaviour.

And the context is changing. The legislative constraints on corporate behaviour, and the social expectations of business, have evolved fast in recent years. The papers in this volume look at the way that process has affected Russia.

The result is illuminating. Russia, like other formerly Communist countries, has had to undergo far greater changes than any experienced by the outside developed world. The very nature of the modern Russian corporation has been a new and rapidly changing element of Russian society. The relationship of private business with the state has been subject to sometimes dramatic change in the past few years. Property rights are not as firm as elsewhere. The execution of tax law, the regularity of the judicial system, the transparency of administration, and corruption are all matters for concern.

But none of this should disguise the fact that there is measurable progress too. Many Russian corporations increasingly see the case for accountable behaviour, and the connection between that and their interest in long term investment, whether domestic or foreign.

Both Russian and outside investors have a direct interest in the way that the assumptions and beliefs that surround Russian business will develop. That is of course a matter of knowing what Russian law may say, and how it is applied. The papers which follow explain that. But they go further, because they deal too with the wider context. It is essential for all investors, and perhaps particularly foreign investors, to understand that context, and to track its evolution. We can all have our different hopes and fears, but we need to know what is really going on before we can judge how best to promote the one and guard against the other.

That should be enough to justify close consideration of the material set out in this volume. But I would commend it for a wider reason too: Russia is an essential part of Europe, and her fate and prosperity matter to all of us on this continent, and beyond it. Russia's future will depend on responsible and effective investment being undertaken now. That future will be more hopeful if both Russian and foreign investment is for the long term, and undertaken with the wider interests of society fully in mind.

London, November 2009

Andrew Wood

*Former British Ambassador to
the Russian Federation*

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Most importantly, however, Fiona Mucklow would like to thank her parents and Nicholas Cheremeteff, and Wybe Douma his mum and Dima Avilov, for all their boundless love, friendship, support and encouragement to follow our paths.

The Hague, December 2009

LIST OF ABBREVIATIONS

A

AA	Assigned Amount
AAU	Assigned Amount Units
AIE	Accredited Independent Agency
AIJ	Activities implemented jointly

B

BAT	Best Available Techniques
BREF	BAT Reference Documents

C

CDM	Clean Development Mechanism
CEB	Council of Europe Development Bank
CHPP	Combined heat and power plant
CIS	Commonwealth of Independent States
COP	Conference of the Parties
CSR	Corporate Social Responsibility
CTE	Committee on Trade and Environment

D

DEA	Danish Energy Agency
DFID	Department for International Development (Great Britain)

E

EBRD	European Bank for Reconstruction and Development
EIA	Environmental Impact Assessment
EIB	European Investment Bank
EIC	Environmental Investment Center
EM	Environmental Monitoring
EMAS	EU Eco-Management and Audit Scheme
EMEs	Emerging Market Economies
EMP	Environmental Management Plan
EMS	Environmental Management System
EQS	Environment Quality Standards
ERPA	Emission Reduction Purchase Agreement
ERU	Emissions Reduction Unit
ERUPT	Emission Reduction Unit Procurement Tender
ET	Emissions Trading
EU	European Union

F

FAS	Federal Anti-Monopoly Service (Russian Federation)
FDI	Foreign Direct Investment
FSC	Forest Stewardship Council

G

GDP	Gross Domestic Product
GEF	Global Environment Facility
GHG	Greenhouse gas
GIS	Green Investment Scheme
GOF	Global Opportunities Fund (now referred to as the SPF)
GRI	Global Reporting Initiative

J

JI	Joint Implementation
JISC	Joint Implementation Supervisory Committee

K

KNPP	Kola Nuclear Power Plant
KP	Kyoto Protocol to the United Nations Framework Convention on Climate Change

L

LULUCF	Land Use, Land Use Change and Forestry
--------	--

M

MED	Ministry of Economic Development (Russian Federation)
MFI	Multilateral Financial Institution
MNR	Ministry of Natural Resources and Environment (Russian Federation)
MSC	Marine Stewardship Council
MtCO ₂ e	Million tonnes of CO ₂ equivalent

N

NEFCO	Nordic Environment Finance Corporation
NGO	Non-Governmental Organisation
NIB	Nordic Investment Bank
NIS	Newly Independent States
NPAF	National Pollution Abatement Facility (Russian Federation)

O

OECD	Organisation for Economic Co-Operation and Development
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P

PDD	Project Design Document
PRI	Principles for Responsible Investing

Q

QMS	Quality management system
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R

RBCC	Russo-British Chamber of Commerce
REEEP	Renewable Energy and Energy Efficiency Partnership
REC CEE	Regional Environmental Centre for Central and Eastern Europe
RF	Russian Federation
RREC	Russian Regional Environment Center
RSPP or RUIE	Russian Union of Industrialists and Entrepreneurs

S	
SER	State Environmental Review
SEI	Statement of Environmental Impact
SPF	Strategic Programme Fund
T	
TACIS	EU Technical Assistance to the CIS
TED	Tenders Electronic Daily
ToR	Terms of reference
TPP	Tidal power plants
U	
UN	United Nations
UNDP	United Nations Development Programme
UN ECE	United Nations Economic Commission for Europe
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFCCC	United Nations Framework Convention on Climate Change
W	
WBCSD	World Business Council for Sustainable Development
WTO	World Trade Organisation

SUMMARY OF CONTENTS

Foreword by <i>Sir Andrew Wood</i>	V
Acknowledgements	VII
List of Abbreviations	XI

Environmental finance and socially responsible business in Russia – An Introduction	1
<i>Fiona Mucklow and Wybe Th. Douma</i>	

Part I: Overview and First Comments

1. The Russian economy in perspective	19
<i>Philip Hanson</i>	
2. Environmentally and socially responsible business in Russia: why bother?	29
<i>Godfrey Cromwell</i>	
3. The importance of socially responsible investing to promote sustainable investments in Russia	35
<i>Tatiana V. Guseva</i>	

Part II: Legal and Policy Perspectives

4. Russian environmental law – An overview for businesses	45
<i>Daria N. Ratsiborinskaya</i>	
5. Russian NGOs and public participation – Legal and practical perspectives	69
<i>Olga A. Razbash</i>	
6. Harmonisation of Russian law environmental standards with EU legislation	85
<i>Dietrich Hahn and Michael Begak</i>	
7. Mechanisms to promote green business in Russia	101
<i>Soili Nystén-Haarala</i>	
8. Environmental policy and the international competitiveness of the Russian economy	121
<i>Evgeny A. Shvarts and Ivetta Gerasimchuk</i>	
9. Environmental education and capacity building in Russia	133
<i>Tatiana V. Guseva</i>	
10. Green public procurement: Using European experiences in Russia	145
<i>Ekaterina N. Khmeleva</i>	

- | | |
|---|-----|
| 11. Can Russia become a ‘Green Investor’ in Southern Africa? | 157 |
| <i>Ivetta Gerasimchuk</i> | |
| 12. The EBRD and Russia: Stimulating European Principles for the Environment | 169 |
| <i>Wybe Th. Douma</i> | |

Part III: Practical Trends and Synergies

A. Business, NGOs and environmental projects

- | | |
|--|-----|
| 13. Involving Russian business in Kyoto | 189 |
| <i>Michael Yulkin</i> | |
| 14. The changing context for investment in green projects in Russia | 203 |
| <i>Jonti Small, Trevor Barton and James Lanman</i> | |
| 15. Russian National Pollution Abatement Facility: Practice and results | 213 |
| <i>Yurij L. Maksimenko and Irina D. Gorkina</i> | |
| 16. Environmental management systems in Russia: The delayed wave | 225 |
| <i>Sergey Dayman</i> | |
| 17. Renewable energy opportunities on the Kola Peninsula | 235 |
| <i>Nina Lesikhina and Michele Hege Grønbech</i> | |
| 18. Investments in Murmansk Oblast and Pomor Region – Some reflections | 249 |
| <i>Jeffrey Roberts</i> | |

B. CSR & philanthropy

- | | |
|---|-----|
| 19. Developing corporate social responsibility in Russia: The role of the United Nations Development Programme | 267 |
| <i>Alexey E. Kostin</i> | |
| 20. Russia: Corporate social responsibility in a post-socialist state | 283 |
| <i>Sergey Dayman</i> | |
| 21. Socially responsible business: Helping children in Russia | 289 |
| <i>Kit Lawry and Joanna Rogers</i> | |

List of Contributors	297
-----------------------------	-----

Bibliography	313
---------------------	-----

Annex I: Useful websites	323
---------------------------------	-----

Annex II: The Equator Principles	329
---	-----

Annex III: UN Global Compact Principles	337
--	-----

Annex IV: Russian Code of Corporate Behaviour	339
--	-----

Annex V: European Principles for the Environment	343
---	-----

Detailed Table of Contents	345
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ENVIRONMENTAL FINANCE AND SOCIALLY RESPONSIBLE BUSINESS IN RUSSIA – AN INTRODUCTION

Fiona Mucklow¹ and Wybe Th. Douma²

As the world economies are experiencing a global financial crisis, matters such as environmentally responsible investing or environmental finance, socially responsible activity and sustainability are increasingly moving to the forefront of mainstream topics of discussion. Not merely of interest to politicians, but also increasingly addressed by businesses globally, environmentally and socially sound investment and business activity appears to be moving to the core of creating a new post-recession world order.

Much attention is paid to the new direction that the USA under President Obama is taking, and where China is heading. However, it is necessary, in addition, to obtain a better understanding of what is happening within Russia. Russia is a key player in many respects. It is the world's third largest emitter of greenhouse gases³ after China and the USA and, thus, could play a vital role in the fight against global climate change. It is also the largest trading partner of the European Union. With Russia's recently stalled economy after almost a decade of exponential growth, the issues of legal certainty (rule of law), environmentally responsible (or 'green') finance and socially responsible business activity, too, are of increasing importance within the framework of Russia's future sustainable development and its role in the international arena.

ENVIRONMENTAL FINANCE IN RUSSIA – TIDES OF CHANGE?

Since embarking on the road of transition to a market economy in 1992, Russia has taken many steps within the sphere of liberalisation, stabilisation, private-sector development and redefining the role of the state. However, and as Philip Hanson (Chapter 1) illustrates, risks and challenges continue to exist, including in the area of environmental finance.

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³ Russia has approximately 1,700 million tonnes of emissions per year, see Energy Information Administration, *International Carbon Dioxide Emissions and Carbon Intensity*, at <http://www.eia.doe.gov/emeu/international/carbondioxide.html>.

Environmental finance⁴ has emerged globally, in particular since the beginning of the 21st century, as a market-based solution to environmental problems. It relies on a limited set of financial products and instruments, including local capital markets, carbon trading, as well as tariffs for environmental services and intergovernmental transfers. However, the reach of environmental finance extends not just to environmental matters, but also to related socio-economic issues. It encompasses voluntary initiatives (e.g., reporting and certification), environmental management systems ('EMS'), corporate social responsibility ('CSR') and touches the financial services sector, insurance business and many other sectors.

Since 2003, innovative policy instruments (such as industry rating, EMS and corporate reporting) have been adopted or further promoted, and traditional instruments (e.g., environmental quality standards, permitting, and environmental liability) have been under reform – and environmental finance in Russia illustrates this dynamic and some of its limitations.⁵

Thus, establishing a modern EMS that matches new economic and social realities is one of the challenges that Russia faces.⁶ Many environmental finance projects have been funded with international involvement, for example within the ambit of the European Bank for Reconstruction ('EBRD'), the Global Environment Facility ('GEF'), the World Bank, the Nordic Investment Bank ('EIB') or the Nordic Environment Finance Corporation ('NEFCO'). However, as this book investigates and aims to exemplify, local efforts, albeit some in their infancy, are underway, too.⁷

As Daria Ratsiborinskaya (Chapter 4) and other authors in this volume discuss, Russia has dedicated major efforts to the development of its environmental legal frame-

⁴ This term encompasses all market-based instruments designed 'to deliver environmental quality and to transfer environmental risk', see Labatt, S., and White, R.R., *Environmental Finance: A Guide to Risk Assessment and Financial Products* (2002). See also editions of the *Environmental Finance* magazine, at (<www.environmental-finance.com>); Labatt, S. and White, R.R., *Carbon Finance: The Financial Implications of Climate Change* (2007). Other useful publications on business and environment are by Willard, B., *The Sustainability Advantage: Seven Business Case Benefits of a Triple Bottom Line* (2002); Holliday, Jr., C.O., Schmidheiny, S., and Watts, P., *Walking the Talk: The Business Case for Sustainable Development* (2002); Schmidheiny, S., *Changing Course: A Global Perspective on Development and the Environment* (1992).

⁵ OECD, *Mobilising Financial Resources for the Environment in Russia* (2008), see <<http://www.oecd.org/dataoecd/23/5/41445931.pdf>> ('OECD 2008 Report'), p. 6.

⁶ See OECD 2008 Report, p. 6.

⁷ See OECD 2008 Report, pp. 6-7; which provides an update of some of the developments in environmental expenditure and finance in Russia. It states that 'recent data collected in Russia and in EECCA countries indicate that environmental expenditure in Russia has increased to levels which compare with some CEE countries'. However, the report continues to comment that the level of expenditure remains low as a share of GDP, and expenditure is still largely concentrated on the water sector. The OECD 2008 Report further states that 'there are opportunities to increase both public and private expenditure volumes, to increase the share of investment in cleaner technologies, and to allocate resources to a wider variety of environmental domains'. The authors in the same report state that this requires making a better use of existing financing instruments and harnessing new sources of finance. The capacity to mobilise additional sources of finance for the environment and to make the best use of them can contribute to a number of issues which are high on the Russian agenda: sustained economic growth, more effective innovation policies, and tackling the health crisis (see OECD, *Economic Survey of the Russian Federation* (2006) and the OECD 2008 Report).

work. Russia has signed and ratified many multilateral environmental agreements and Russian environmental laws and regulations now address most of the priority environmental issues.⁸ Unlike the USA, it ratified the Kyoto Protocol (in 2004, so enabling the KP to enter into force) under then President Vladimir Putin.

Nevertheless, and as has been widely publicised, environmental challenges still exist in Russia⁹ – related in part to a (not unreasonable) focus on economic development, inconsistent implementation and enforcement of Russian environmental laws and perhaps also due to the main state body on environmental affairs, the State Committee on Environmental Protection ('Goskomekology') being closed in 2000, and its functions having been transferred to the Ministry of Natural Resources.¹⁰

Since the beginning of the 21st century, change in Russia, towards the creation of more 'green' and socially responsible public and private sectors, appears to be underway. It is notable that at the highest political levels, calls have been made to diversify investments in Russia, away from the traditional focus sectors connected to natural resources (such as oil, gas, forestry, minerals). Moreover, growing environmental consciousness was exemplified with a change in the planned route of the Eastern Siberia-Pacific Ocean ('ESPO')¹¹ oil pipeline being ordered, so as to minimise the risks to Lake Baikal,¹² the world's largest freshwater lake and a UNESCO World Heritage site. Towards the end of his presidency in 2008, then President Putin expressed that '[w]orking to protect nature must become the systematic, daily obligation of state authorities at all levels'.¹³

Russian President Medvedev has also expressed his support for environmental responsibility and stated that '...in the coming years the quality of the environment will

⁸ See OECD 2008 Report, p. 6 and OECD, *Policies for a better environment. Progress in Eastern Europe, Caucasus and Central Asia* (2007) ('OECD 2007 Report').

⁹ For example, OECD reports that the magnitude of these challenges can be illustrated by the fact that about 15% of Russia's territory suffers from exposure to high levels of ambient pollution. In many industrial centres (e.g., Dzerzhinsk, Irkutsk, Kemerovo, Krasnoyarsk, Novokuznetsk, Norilsk, and Cherepovets), the rates of morbidity and mortality are reported exceed 1.5-3 times the national average – see OECD 2008 Report, p. 9, and OECD, *Environmental Policy and Regulation in Russia. The Implementation Challenge* (2006) ('OECD 2006 Report'). See also Weiner, D.R., *A Little Corner of Freedom: Russian Nature Protection from Stalin to Gorbachev* (1999); Murray, F., *Ecological Disaster: Cleaning up the Hidden Legacy of the Soviet Regime* (1995); further material about Soviet environmental pollution see Feshbach, M. and Frenkel, Jr., A., *Ecocide in the USSR: Health and Nature under Siege* (1992).

¹⁰ The Yeltsin administration had demoted the Ministry of Ecology to Goskomekology in 1996. Recently, the Ministry of Natural Resources was renamed Ministry of Environmental Resources and Ecology ('MNR').

¹¹ See <www.ihsglobalinsight.com/SDA/SDADetail5684.htm> and <<http://en.rian.ru/russia/20080303/100502195.html>>; the construction of the 2,550 km ESPO pipeline by Transneft started in 2006; see also <www.hydrocarbons-technology.com/projects/espipeline/>.

¹² Situated in south-east Siberia, the 3.15-million-ha Lake Baikal is the oldest (25 million years) and deepest (1,700 m) lake in the world. UNESCO reports that it contains 20% of the world's total unfrozen freshwater reserve. It is known as the 'Galapagos of Russia', its age and isolation have produced one of the world's richest and most unusual freshwater faunas, which is of exceptional value to evolutionary science, see <<http://whc.unesco.org/en/list/754>>.

¹³ ABC News 8 February 2008, *Putin, Medvedev courting Russia's green vote*, at <www.abc.net.au/news/stories/2008/02/08/2157436.htm>, accessed 3 April 2009.

be a key factor in the competitiveness of each Russian region'.¹⁴ At a meeting with the Minister of Natural Resources and Environment, Yury Trutnev, the new President also called on the government, civil society, and the business community to give priority to the improvement of the environment regardless of short-term issues. 'Our common goal – both that of the government, civil society, and the business community – is to continue working to make the environment healthier,' he said. 'Even when business sees its resources shrinking, it should not stop and should commission new environmentally friendly facilities, improve purification systems, reduce emissions, and so on.' 'All this work should continue non-stop, regardless of any external or internal reasons,' he stated.¹⁵

OLD PERCEPTIONS AND NEW CIRCUMSTANCES

The general perception amongst foreign investors is that Russia remains a challenging (though potentially very lucrative) market, which requires only minimal focus on environmental and social issues. 'Bad press', e.g., relating to the rule of law, transparency and corruption, has contributed towards the international business community being cautious about the viability of 'green' projects or focusing on taking seriously their social responsibilities in Russia – whilst domestic Russian companies are often sceptical of green initiatives or 'social responsibility' corporate policies due to perceived costs, lack of information and experience of successful environmental or socially responsible ventures.

This book hopes to adjust these perceptions and aims to exemplify that steps are being taken by Russia, as well as by businesses operating in Russia, in addressing environmental and social issues. The aim is to present a more accurate view of Russia's progress towards sustainable development and of recent Russian business practices. There are many opportunities and challenges that exist from a legal, as well as from a practical and policy perspective, however, the message is clear: environmentally and socially responsible investing and business activity is underway in Russia. Many real opportunities exist for businesses to participate in environmental and socially responsible projects in Russia.

The editors have chosen to combine the topics of 'environmental finance' and 'socially responsible business' in this book as they are of the opinion that these two topics are inextricably linked. Environmental finance or environmentally responsible investing cannot be effective without taking account of social issues. And businesses purporting to act in a socially responsible manner cannot be considered to be doing so effectively without undertaking environmental investments, in tandem. The one is not complete without the other.

Thus, ultimately, this book aims to contribute towards facilitating and promoting sustainable development in Russia. It is developed within the general spirit of the pro-

¹⁴ 30 January 2008, <www.medvedev2008.ru/english_2008_01_30.htm>.

¹⁵ See Interfax, 29 October 2008, at <<http://www.cdi.org/russia/Johnson/2008-197-47.cfm>>.

visions of the *Millennium Declaration*, the *Johannesburg Declaration on Sustainable Development*, which provide that ‘the private sector, both large and small companies, have a duty to contribute to the evolution of equitable and sustainable communities and societies’ (Article 27); as well as the provisions of the *World Summit on Sustainable Development Plan of Implementation* (‘PoI’), which states that:

‘Poverty eradication, changing unsustainable patterns of production and consumption, and protecting and managing the natural resource base of economic and social development are overarching objectives of, and essential requirements for, sustainable development.’ (Art. 2)

The PoI emphasizes, *inter alia*, the need to enhance corporate environmental and social responsibility and accountability (Article 17), and the need to actively promote corporate responsibility and accountability based on the Rio Principles, and support continuous improvement in corporate practices in all countries (Article 45ter).

Naturally, due to space constraints, and in no way for lack of their importance, numerous issues related to environmental finance and socially responsible business practices are not addressed (in full or at all) in this book – including, the development of the protection of human rights, such as indigenous peoples’ rights, intellectual property rights issues, the rule of law, tax law and practice, transparency, corruption and other debilitating social matters, such as racism, alcoholism and sexism.

Over half of the authors presenting their views in this volume are from Russia, and most of the non-Russian authors have worked extensively in Russia. Together, the authors offer a practical account, and in some instances a reflective analysis, of the state of play of ‘green’ investments in Russia and how local and foreign businesses are operating in an increasingly more socially responsible manner. The result is a collection of chapters, each written in the style of the authors, focusing on a myriad of separate but interrelated issues. This provides for a varied introductory overview of where we stand today and how current and future generations of Russian and foreign businesses can continue to add value in an emerging market such as Russia.

OUTLINE OF THE BOOK

The contributions in this volume are grouped into three parts. The aim is to provide some structure in very much over-lapping topics and subject matters.

Part I acts as an overture, sketching the broad picture. On the one hand, Phil Hanson provides an introduction on the development of Russia’s economy – from the turmoil in the post-communist days, through the exponential growth to the recent decline (Chapter 1). This account is followed by Godfrey Cromwell and Tatiana Guseva’s chapters, which focus on the role that environmentally and socially responsible business and investing can play in Russia, taking into account its historical background, as well as its frail legal and social system (Chapters 2 and 3).

Part II focuses on the legal and policy aspects of investing and doing business in Russia. Daria Ratsiborinskaya starts off with a description of Russia's environmental law (Chapter 4). The role of NGO's in promoting green investments and their interaction with businesses in Russia is addressed by Olga Razbash (Chapter 5). Next, Dietrich Hahn and Michael Begak set out how the EU-TACIS harmonisation of environmental standards project in Russia raises new questions and issues. They discuss the aims of this project of approximating Russia's legal system with that of the EU where industrial permitting is concerned (Chapter 6). Thereafter, Soili Nystén-Haarala provides an insight into the status of governmental mechanisms in Russia, which are set to promote green business (Chapter 7). Evgeny Shvarts and Ivetta Gerasimchuk highlight how environmental policy and international competitiveness of the Russian economy can go hand in hand (Chapter 8). In Chapter 9, Tatiana Guseva discusses how environmental education and capacity building in Russia has developed. Ekaterina Khmeleva turns to an important potential instrument that could stimulate further greening of Russian society and business, namely green public procurement (Chapter 10). Ivetta Gerasimchuk discusses the interesting question as to whether Russia could become a "green investor" in Southern Africa (Chapter 11). In the final chapter of Part II, Wybe Douma reviews how the EBRD promotes the use of European Principles for the Environment and the application of Russian as well as European environmental law (including the system of using Best Available Techniques) when issuing permits to projects sponsored by this bank (Chapter 12).

Part III shifts the focus to practical trends and synergies. Here, the authors set out how businesses and NGOs have participated in 'green' projects (Part III.A) and how corporate social responsibility ('CSR') and philanthropy have developed in Russia (Part III.B).

Michael Yulkin discusses the involvement of Russian business in the Kyoto Protocol (Chapter 13), whilst Jonti Small, Trevor Barton and James Lanman focus on the changing context for green investment, including with respect to the Kyoto Protocol (Chapter 14). Yuriy Maksimenko and Irina Gorkina discuss the practice and results of the Russian National Pollution Abatement Facility (Chapter 15). Whilst in Chapter 16, Sergey Dayman reviews how environmental management systems are increasingly becoming part of business operations in Russia, Nina Lesikhina and Michele Grønbech provide an interesting account of the opportunities of introducing renewable energy on the Kola Peninsula (Chapter 17). Finally, Jeffrey Roberts provides a personal account and reflections of his experiences of investments in the Murmansk Oblast and Pomor Region (Chapter 18).

In Chapter 19, the first in Part III.B, Alexey Kostin extensively discusses CSR in Russia and the role the Russian office of the United Nations Development Programme ('UNDP') played in this respect. This chapter is in slight contrast to a shorter contribution in Chapter 20, wherein Sergey Dayman sets out the role CSR plays and can play in a post-socialist state, such as Russia. Finally, Kit Lawry and Joanna Rogers debate the role of businesses in helping children in Russia within the framework of EasyChild, an international children's support organisation (Chapter 21).