The two-market approach

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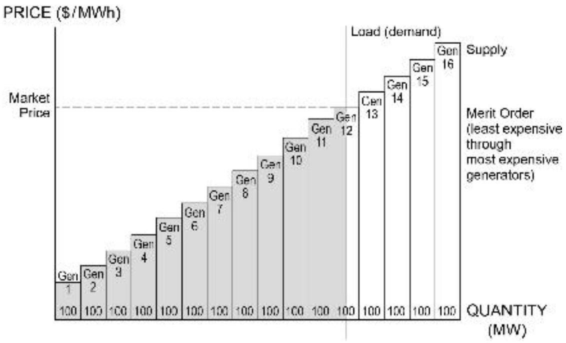
The traditional view of wholesale electricity markets



There were always problems – *but now they are unmanageable*

- Many system and generation costs fixed; marginal costs may not give the right signals for investment

No signals for investment *renewables penetration depresses prices below LRMC*

- Clustering and herd behaviour – discourage diversity.

The cluster is now at zero and non-dispatchable; ***no signals for operation.***

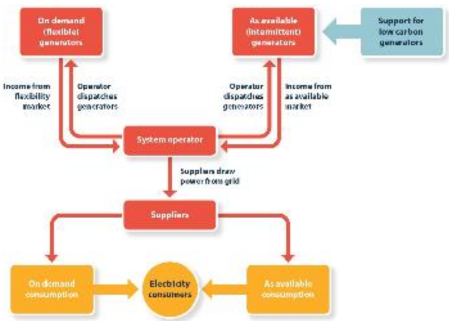
- Consumer prices – not designed to encourage active response.

No useful signals for demand-side*. Consumer price signals administratively determined – yet demand flexibility is now a priority*

- ***No system optimisation***

- ***No exit strategy*** *('pecuniary externalities')*

The two market approach



Why two markets?

- Need to get away from price contamination (**pecuniary externalities**) and provide an exit strategy.
- Need proper **flexibility markets** (missing markets)
- **Capacity markets** – centralised and distortive
- **VOLLs** – a Dead Sea fruit
- **Stated preferences** unreliable – need to enable the expression of revealed preferences
- **But** it's a fundamental change – there may not be appetite for such a big step.

Conclusions

- Electricity markets are no longer fit for purpose
- But any redesign must address all the problems, not just pick one or two
- Electricity wholesale markets will be at the centre of system optimisation – which will be much more complex in future
- Consumers, not system operators, need to be at the centre of electricity markets – even if it means fundamental change