

Marginal Pricing Works - The Most Efficient Foundation for Electricity Markets

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Integrated wholesale markets built on marginal pricing deliver large consumer welfare gains

Marginal pricing, facilitated through pay-as-clear auctions, determines the market clearing price at the supply–demand equilibrium and is the standard trading and settlement mechanism that aligns short-run dispatch with consumption needs and promotes the efficient use of cross-zonal capacity. This provides economic efficiency and generates transparent scarcity and surplus signals that support flexibility and investment.

European economic competitiveness and energy affordability can be better achieved via complementary instruments, which build upon liquid markets, rather than by redesigning wholesale price formation. This was acknowledged during the 2023 review of the Electricity Market Design. On that occasion, European institutions concluded that the current design functions most effectively and shall be preserved. Continuous changes undermine long-term investments and increasing market risks.

A uniform price structure is economically coherent for a uniform product

Electricity is a non-fungible, uniform commodity that must be priced according to demand and supply equilibrium. In the wholesale electricity market, generators submit offers and the market clears where aggregated supply meets demand. The last accepted lowest priced offer sets a single clearing price within that settlement interval. This supports leastcost dispatch because lower variablecost resources are selected first (i.e. the meritorder effect). The marginal unit's cost reflects scarcity and the opportunity cost of meeting one more unit of demand at that time.

Marginal pricing remains the only efficient pricing system

Marginal pricing is the only efficient and core price formation mechanism and settlement rule for competitive electricity markets . It minimises total operating cost in each interval, rewards flexibility when the system is scarce and provides a transparent scarcity signal for demand response, storage and firm capacity. Moreover, it integrates renewables efficiently: zeromarginalcost wind and solar bid in at lower variable cost displacing highercost generation and lowering prices when they are abundant, while uniform prices allow capitalintensive lowcarbon assets to recover fixed costs over time.

A single and clear spot reference underpins long-term markets, enabling competitive hedging and stabilising retail offers.

Crucially, a clear and credible spot market price is the base for forward contracting, including futures and forward, used for longterm hedging. This supports liquidity, price discovery, and risk transfer, functions that are particularly important in power systems with rising shares of variable renewables and tighter flexibility needs.

It must be noted that volatility is a feature of scarcitybased systems, not a flaw of marginal pricing. Shortrun price swings communicate when flexibility is valuable and help ration demand when supply is tight. Suppressing that signal tends to shift costs into nontransparent mechanisms. In the long term, this undermines investment in flexibility and firm capacity.

Prices are driven by fundamentals

Marginal pricing in day-ahead auctions remains the most efficient mechanism for costeffective dispatch, transparent price signals and investment incentives that reflect realtime system value. It is the only pricing mechanism suitable for any uniform commodity and represents the standard model applied in most electricity markets. This is not unique for electricity, neither is it determined by a specific regulation. It is merely how markets price uniform products in the most cost-efficient manner.

About

Europex is a not-for-profit association of European energy exchanges with 36 members. It represents the interests of exchange-based wholesale electricity, gas and environmental markets, focuses on developments of the European regulatory framework for wholesale energy trading and provides a discussion platform at European level.

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