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The coming fight over the EU's budget

di Paola Tamma

Member states are embarking on two years of haggling over spending priorities amid growing doubts about the bloc's political direction and its ability to compete with the US and China.

Piotr Harasimowicz created CDeX to train cyber security specialists in a real-world environment: an IT training range where participants have to fend off attacks by hackers.

A €2.3mn grant from the EU budget helped him launch CDeX. If Brussels has its way, far more money from the next iteration of the bloc's budget will be going to entrepreneurs like Harasimowicz, rather than to its traditional recipients: farmers, local mayors and regional governors in member states.

As EU leaders gather today for a first exchange of views on a proposed €2tn seven-year budget, the issue of Europe's geopolitical and economic relevance looms large.

Who gets the most from the EU budget?

Gross national allocations from current and proposed budget (€bn)



Sources: European Commission; FT research

US GDP per capita is now twice that of the bloc, while America's massive tech groups increasingly dominate AI and other key technologies. A European economic model based on open markets and cheap energy has been undermined by Russia's war in Ukraine and its own policy mis-steps in sectors such as carmaking — where it has announced tough targets only to row back later.

European nations also face having to spend significantly more on defence rather than relying on the US, whose aggressive trade policies and recently released national security strategy have laid bare President Donald Trump's contempt for the EU.

In responses to these challenges, along with last year's report on the bloc's waning competitiveness compiled by former European Central Bank president Mario Draghi, the European Commission in July proposed sweeping reforms to the common budget.

It has promised a more flexible and efficient structure that would shift the bulk of spending away from farming subsidies and poorer regions towards boosting economic competitiveness and strengthening the continent's defences.

Commission president Ursula von der Leyen has called it a “budget for a new era” that “matches Europe’s ambition, that confronts Europe’s challenges and that strengthens our independence”. But agreement on the budget requires unanimity among its 27 member states and approval from the European parliament. Already, battle lines are drawn.

Countries that are net recipients of EU spending have a vested interest in maintaining the structure and increasing the size of the budget, while net payers support a tighter budget that is more focused on today’s challenges.

Even within each country, stakeholders jostle for advantage: regional governments, farmers’ lobbies, business associations, civil society, even different government ministries.

“Negotiations are taking place on many different levels. It’s a bit like 3D chess,” says Sebastian Fischer, chief EU budget negotiator for Germany.

The EU budget is a relatively small pot of money — historically about 1 per cent of the bloc’s GDP, or around €380 per EU citizen per year over seven years — that funds the EU’s machinery and its policies.

It is largely financed by member states according to economic weight, as well as from some EU-specific revenue streams known as “own resources”, such as customs duties and a slice of member states’ VAT revenues.

At present, about a third of it is spent on agricultural subsidies under the bloc’s Common Agricultural Policy, a mechanism that dates back to the foundation of the European Economic Community in 1957. While CAP spending has already shrunk significantly from the 70 per cent of the budget it absorbed in the 1970s, the current proposal envisages cutting it by another fifth.

The reaction from farming lobbyists has been predictable. “We are very far from a budget capable of supporting primary agricultural production with respect to the challenges of food self-sufficiency that we must achieve in Europe,” said Massimiliano Giansanti, president of Copa, a farming union. Another third of the current budget is distributed to less developed regions in the form of “cohesion” funds that are meant to reduce economic disparities within the bloc. The commission wants to cut these by about 10 per cent.

More controversially, it proposes wrapping agriculture and cohesion payments into a so-called single national envelope, giving much more leeway to national governments to spend EU funds as they wish. The commission argues this will make funding more agile and allow it to address complex challenges, rather than being committed in advance to rigid spending programmes, each with their own requirements and often with overlapping goals.

But it has run into opposition from the European parliament, which feels that Brussels is sacrificing its traditional constituencies. Siegfried Mureşan, a Romanian MEP and one of the parliament’s co-

negotiators for the budget, says the proposal will “reduce the predictability to the farmers and for the regions”.

“We believe these are different types of beneficiaries . . . They shouldn’t be asked to compete with each other.”

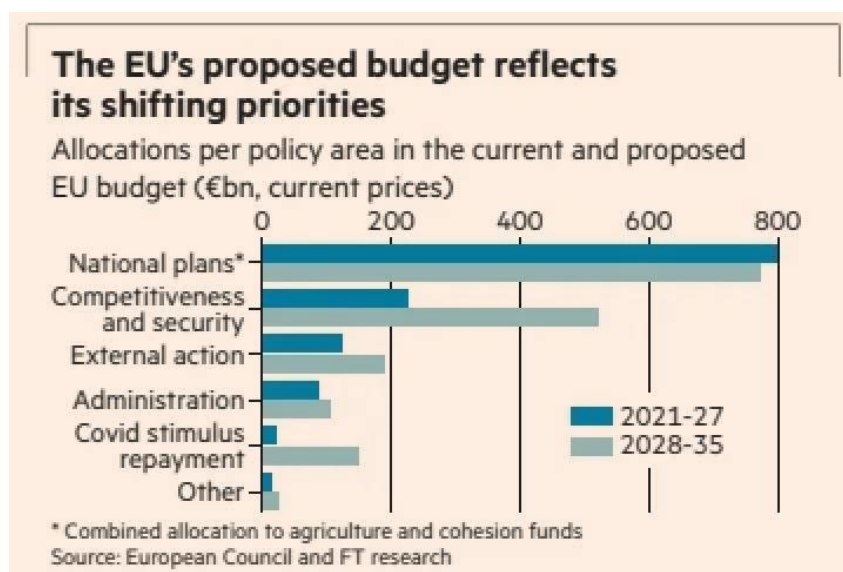
After the parliament threatened to reject the proposal outright, the commission agreed to give regional governments a say over how the money is spent under the national plans, impose a “rural target” obliging countries to spend 10 per cent of their total envelope on rural areas, and allow the parliament a bigger voice in the budget process.

The spending area set to receive a boost under Brussels’ proposal is a new €409bn European Competitiveness Fund, which would double research funding to €175bn, as well as €130.7bn dedicated to defence and security — a fivefold increase compared with the present budget. The rest would be earmarked for other priority sectors such as clean tech, digital and health.

These funds would be disbursed on a competitive basis to the most worthy research institutions and innovative businesses. Smaller and poorer countries fear this will inevitably benefit richer countries already endowed with cutting-edge research and start-ups. The smaller states want to add a “geographical balance” criterion to ensure a wider distribution of funds.

But supporters of the new approach argue that the EU needs to back its winners. “If you want to keep up with the US and China and other leading powers . . . you cannot do that with diluted funding, you need to concentrate on the best we have,” says Philipp Lausberg, senior policy analyst at the European Policy Centre, a think-tank.

Germany and other net contributors are particularly supportive of the arrangements for innovation funds. “We can’t address the huge challenges of today using an EU budget whose structure is rooted in the last century,” says Fischer, the German negotiator.



Critics say the current system, which has been used for decades, is too slowmoving given the unpredictable economic and geopolitical environment.

Every seven years, the commission issues a proposal for a budget. After about two years of haggling, it then pays out for the seven following years — meaning the cash is spent up to nine years after it was first earmarked.

But the countries that receive the bulk of cohesion and agricultural funding, such as Poland, oppose the cuts and the plan to merge the two.

“We’re happy with the proposed size of the EU budget,” says Ignacy Niemczycki, Poland’s state secretary for EU affairs. “But there should be more balance between old priorities like cohesion and agriculture and new priorities like competitiveness.”

The overall size of the package is another key bone of contention. Berlin, which bankrolls about a quarter of the budget, argues that the EU should do what it is asking member states to do: spend less, but do it more effectively.

Germany rejected the proposed budget within hours of it being unveiled in July. “A comprehensive increase in the EU budget is unacceptable at a time when all member states are making significant efforts to consolidate their national budgets,” said Stefan Kornelius, a government spokesperson. Berlin also wants to keep a system of “rebates” or discounts that Germany — alongside Denmark, the Netherlands, Austria and Sweden — receive on their net contributions to the budget. The commission wants to abolish them.

The European parliament is calling for a 10 per cent increase on the proposed €2tn budget.

Mureşan, the Romanian MEP, complains that the overall amount of funding does not meet the EU’s rising needs, pointing out that the proposed budget amounts to 1.26 per cent of the bloc’s gross national income, a small increase compared with 1.13 per cent in the present one.

“We cannot do more with less. If we agree that the European Union should do more to provide security to the citizens and to improve competitiveness, it cannot achieve these goals with a budget which is equal in size,” he says.

Germany and other countries are also sceptical of Brussels’ plan for financing the increased spending. New EU levies worth about €400bn are being proposed, including taxes on things such as electronic waste, handling fees on small packages sent from third countries, and increases in tobacco duties, as well as increases in existing sources of revenue like customs levies and VAT.

A proposed tax on the profits of big companies has particularly roiled countries that feel it runs counter to the objective of increasing European business competitiveness. “It’s in contradiction with the competitiveness agenda of the budget,” says Fischer.

But cash-strapped countries see few other ways to maintain EU spending while dealing with fiscal pressures at home. France, the second-largest net contributor to the budget, argues for an increase in EU spending to be funded by new joint debt and new EU-level taxes.

Debates over the budget are further complicated by the need to start repaying the EU's post-Covid recovery fund starting in 2028, which would amount to €168bn over the next seven-year budget period.

While Paris, Rome and Madrid favour rolling this debt over, Berlin adamantly opposes extending or issuing new EU debt, arguing that it was agreed during the pandemic only as a one-off event. "We cannot accept new debt instruments, for a number of political and economic and legal reasons," Fischer says.

Yet another change that the commission wants to implement that has raised opposition is to make all EU money conditional by linking funds to national reform and investments. Disbursements would also be tied to respect for the rule of law and EU values. At present, the EU can withhold or claim back funding only after a lengthy procedure involving member states, the commission and the parliament. In the new proposal, conditions would have to be met prior to disbursements being made.

While that would give the commission leverage to extract concessions from recalcitrant countries, it could also lead to stand-offs that pit national governments against Brussels, with fund beneficiaries losing out.

In the current budget cycle, the commission froze Hungary's cohesion cash, saying the country was not respecting values enshrined in the EU's Charter of Fundamental Rights. Regional and local governments in Hungary were starved of EU funds as a result.

The city of Budapest was allocated almost €800mn for projects including flood protection, housing and sustainable mobility, but has so far received around €70mn — and holds out little hope of unlocking the rest. "You can really get trapped in a system of national authority and conditionality," says Kata Tüttő, a city councillor and president of the Committee of the Regions, the EU body of local governments. "I understand the conditionality system but it is punishing Budapest, 100 per cent."

Cutting back the layers of approvals that the budget requires, and making it more accessible to European industry, is critical to convincing national capitals of the commission's new approach. "For smaller companies, for start-ups, it's always a challenge" to raise funds, says Harasimowicz, whose CDex already has dozens of clients. "Thanks to this [grant], we were able to present our idea and our running software to big companies, and luckily, we got granted contracts with them," he adds.

A lot of the thorniest issues around the size and structure of the budget will only be resolved during the end-game of negotiations, expected from late 2026 onwards, as countries are forced to make concessions and soften red lines for the sake of finding an agreement.

As negotiations advance, it is clear that many of the commission's proposed changes will inevitably be downsized or even reversed. "Even though I would say it's already quite an interesting proposal, and you could make quite a difference with it . . . it very likely will not go through as it's proposed now," concedes Lausberg.

Last time, it took EU leaders four days of nonstop talks to settle on a budget, and some argue even that consensus only emerged thanks to the push to agree the €800bn post-Covid stimulus fund, which was added on in the midst of the pandemic.

António Costa, the president of the European Council who is in charge of brokering an agreement, is targeting a deal ahead of the French presidential elections in spring 2027, fearing negotiations could be complicated by the potential arrival of a much more Eurosceptic administration in Paris. The size of the package, and the proportion shifted to new priorities, will be the make-or-break issues. As one EU diplomat puts it: "A year and a half from now, net contributors will only agree to a larger budget if it offers enough funding for policies that will finally bring the EU into the 21st century."