

Guns over Rice: The Impact of US Military Aid on South Korean Economic Reconstruction*

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〈ABSTRACT〉

South Korean economy was heavily dependent on US aid throughout the post-war reconstruction period. From the American perspective, the primary purpose of aid was to sustain South Korea's national security state whether it was nominally military aid or civilian economic aid. At no time this intention was clearer than the reconstruction period of 1953-1960, when all American aid was subsumed under the purview of the Mutual Security Act. Aid to the military proper started as high as 40% of the total aid volume in the immediate aftermath of the war and never dipped below 20%. Moreover, the foodstuffs and agricultural products delivered as grants-in-kind under Public Law 480 were largely diverted to the South Korean military budget via the counterpart fund. This policy of guns over rice has received much criticism for dragging economic recovery and development in the 1950s despite its important role in maintaining the large military forces for national security. Analyzing available data for US military aid to South Korea, I argue that military aid might have lessen the diversion of economic aid to defense spending, making an indirect contribution to the economic reconstruction.

*Key Words: military aid, economic aid, reconstruction, security, development

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I . Introduction: intended and unintended consequences of American aid

The impact of American aid to South Korean economic development has been a contentious topic since the establishment of the Republic of Korea. Historians and social scientists from both left and right of the ideological spectrum have been interpreting the same set of facts into different conclusions. While most of them agree on the key role American aid played to prop up the South Korean political economy that was still reeling from the devastation of the Korean War, opinions start to diverge when it comes to the medium and long-term effect of aid on sustained development of the South Korean economy.

As we shall see, it was never a secret as to where the US government intended to use its aid primarily - South Korean national defense. It was clearly spelled out in the first agreement between the UN Command and the Republic of Korea over aid (the Meyer Agreement of 1952), and US officials kept reminding their South Korean partners that the counterpart fund - revenue from selling in-kind grant aid - should not be 'diverted' from the original purpose of defense support. Those who were critical of "aid-dependent economy" of the Syngman Rhee regime had simply to point to this defense-oriented American aid as the main culprit of retardation of economic recovery and reconstruction in the 1950s.

There is an implicit counterfactual assumption in that kind of criticism: had American aid been primarily used for economic purposes, South Korean development might have started even earlier and remained more robust. But the predominant cold war calculation for survival was that South Korea had to retain something like a "million man strong army" to keep the communist threat at bay. Given the preoccupation with security at the time among both American and South Korean political elites, and without the benefit of historical hindsight, the defense-oriented aid was a logical consequence.

If 'economic aid' to South Korea was not really for economic

reconstruction but for military build-up, what do we make of 'military aid' per se? Prior research largely overlooks American military assistance to South Korea probably because the relevant data were either classified or not systematically collected. It is the previously unexplored impact of American military aid on South Korean economy that this paper calls into attention. If military aid were used to defray the costs of maintaining a gigantic standing army such as South Korea's, would it not free up more resources for economic reconstruction? An unintended consequence of American military aid to South Korea, I would argue, was that it made room for economic aid to live up to its name as it was diverted from defense expenditures. It would still be difficult to show a direct effect of military aid on economy, yet military aid provided the South Korean government some respite from sustaining its overdeveloped military forces; the South Korean government was then able to make substantial commitment to investing in the long-term development.

There is some relevant literature on the economic impact of the US military aid. Wolf (1971) spells out two opposing theoretical viewpoints on the impact of military assistance on the recipient's resources for economic development. First is the "resource diversion" view, in which military assistance harms economy "by reducing the margin available for civilian capital formation and skill formation." Second is the "resource addition" view that augments "the recipient's economic base" (Wolf, 1972, p.3). Empirical studies based on Wolf's theory found support for the resource addition model in the Israeli case before 1980 (McGuire, 1982; 1987) and the case of the 28 recipients of Military Assistance Program (MAP) from 1967 to 1979 (Stein et al., 1985). However, after analyzing the 28 recipients of Foreign Military Sales Credit (FMS) from 1978 to 1986, Bae (1993) concluded that FMS led to "resource diversion". Following Wolf's own argument, one can take an educated guess that the South Korean case was conforming to the resource addition view. Still, it requires a careful historical investigation to confirm such a guess.

II. Military and economic aid in the South Korea-US relations

1. Shaky distinction between military and economic aid

American aid to foreign allies dates back to the Lend-Lease Act of 1941, which installed a gargantuan military aid program during World War II. A total of 50.1 billion USD-worth of materiel had been shipped to the Allied nations, including the Soviet Union. It was succeeded by the European Recovery Program - the Marshall Plan - which provided economic aid of about 12.7 billion USD (Schain, 2001). The military origin and comparative magnitude of American aid was not lost to the Korean scholars who have conducted important research on American aid to South Korea (Hong, 1962, 1964; No, 1989; Lee, 2002).

In fact, South Korea had almost never received 'purely economic' aid from the US until the Foreign Assistance Act (FAA) of 1961 created the United States Agency for International Development (USAID). During the US military occupation period (1945-1948), South Korea received emergency aid through GARIOA (Government and Relief in Occupied Area) and EROA (Economic Rehabilitation in Occupied Area) that came straight from the US Army budget. The Economic Cooperation Act (ECA) of 1948, which established the Marshall Plan, did virtually nothing except for revealing that "a self-sustaining economy in South Korea per se was never a major goal of American aid programs for South Korea during this period" (Ahn, 1992, p. 80).

Indeed, the ECA program for South Korea was not given a fair chance by the US Congress to achieve its stated goal, only to be transferred to UNKRA (United Nations Korea Reconstruction Agency) and CRIK (Civilian Relief in Korea) with the outbreak of the Korean War. UNKRA was considered by many the only program aimed primarily at South Korea's self-sustaining economic reconstruction, but it was severely underfunded by the UN member nations who pledged 207.6 million USD but delivered

only 70.8 million in total (Lee, 2002, pp. 319-320). During the wartime, furthermore, UNKRA played second fiddle to much bigger CRIK, another emergency relief aid that largely came from the US Army budget despite its civilian-sounding name (Ahn, 1992, pp. 109-111; Lee, 2002, pp. 213-215). By contrast, the first 'pure' American military aid came through without causing as much fuss in the U.S Congress after an agreement was signed between the US and South Korea in January of the same year under the Mutual Defense Assistance Act (MDAA). The initial amount of the military aid, 4.5 million USD in FY 1950, was to be ballooned nearly tenfold five years later.

〈Table 1〉 American aid programs to South Korea that started before 1951

Agency	Program/Law	Period	Amount (million USD)
US Military	GARIOA	1945-1949	502.1
Economic Cooperation Administration	ECA	1949-1951	110.9
United Nations Korea Reconstruction Agency	UNKRA	1950-1955	111.6
UN Command	CRIK	1950-1956	457.2
US Military	MDAA	1950-1951	10.8

Source: Ahn (1992, p. 376), USAID

Given the situation South Korea faced during the disastrous period of 1945-1953, the distinction between military and economic aid does not make much of a sense if we think of the latter as official development assistance (ODA) in the contemporary parlance. American aid to South Korea in this period can be better understood under the rubric of emergency relief, which GARIOA and CRIK provided, while acknowledging marginal presence of 'pure' military and development assistance programs. In terms of the content of aid, almost 70% of GARIOA was composed of foodstuffs, fertilizer, and clothing, and so was CRIK (Hong, 1961, p. 49, 55; Kim, 1967, p. 45). Therefore, even though the US military took on the bulk of funding obligations of aid and administered its implementation, it is difficult to characterize American aid to South Korea during this period as

defense-oriented.

A drastic change in American aid policy came in the midst of the Korean War as the Truman Administration authorized 7.5 billion USD of foreign military and economic aid under the Mutual Security Act (MSA) of 1951 and created Mutual Security Agency, later renamed as Foreign Operations Administration (1953), and then succeeded by International Cooperation Administration (1955), to oversee aid operations. Integrating the previously bifurcated legal provisions of ECA (economic) and MDAA (military) under one umbrella, MSA was crystal clear about its security-first nature not only in the very title, but also in the stated goal "to maintain the security and promote the foreign policy and provide for the general welfare of the United States by furnishing assistance to friendly nations in the interest of international peace and security." It is therefore not surprising at all that the first chapter of MSA was on military assistance, and the second chapter on economic assistance was headed by the section on defense support.

Under MSA, economic assistance other than defense support consisted of Development Loan Fund (DLF, added by the 1958 Amendment), technical assistance, and special assistance. South Korea received no special assistance, and the combined amount of the other two programs was less than 5% of economic aid provided by ICA. It means that defense support accounted for more than 73% of all economic aid South Korea received between 1953 and 1961 (Hong, 1961, p. 43, 83).

The donor's intention was one thing, and the actual use of aid by the recipient was another. Except for DLF and a tiny loan portion of GARIOA, all economic aid to South Korea was grant-in-kind that required sales in domestic currency to be monetized and then had to be deposited in the counterpart fund. Had the US had its way under MSA, a lion's share of the counterpart fund should have been transferred to South Korea's defense budget. In fact, the opposite took place - the South Korean defense budget portion of the counterpart fund never reached beyond 46% until MSA was superseded by FAA, ostensibly ending the security-first foreign aid policy of the US. Even considering in-kind aid that went

directly to the South Korean military received without going through the counterpart fund, the defense budget accounted for by foreign aid sources did not exceed 48% during the 1950s (Kim, 1967, pp. 135-136). As shown in Table 2, a bulk of the counterpart fund was 'diverted' into other priorities presumably set by the South Korean officials.

〈Table 2〉 Cumulative expenditures transferred from the counterpart fund, 1954–1963

Budget item	Amount (million KRW)	Percentage
Defense	7,050	48
Special account for economic reconstruction	4,720	32
Special account for foreign capital reserve	100	1
Fiscal loans	2,650	18
Administrative costs	150	1
Total	14,670	100

Source: Hong (1964, p. 148)

It is interesting to note that the defense portion failed to reach half of the counterpart fund and the rest of the items, except for the administrative costs, were all related to economic development. The aid materials might have been intended for South Korean military when they left American shores, but the story changed quite a bit by the time they were unloaded at Korean ports and quickly sold at market prices. The money from the sales flowed into the South Korean government coffers.

However, it is debatable whether South Korean officials had enough power and/or will to frustrate the security-first aid policy of the US. Those who carefully studied the aforementioned Meyer Agreement and the Combined Economic Board (CEB), established to review and implement aid under MSA, would definitely argue to the contrary. According to a report produced by the Research Department of the Korean Industrial Bank:

One has to wonder if the Korean participation in the CEB is meaningful at all when about 90% of agenda items put on the Board come from the American side... The OEC [Office of Economic

Coordinator], which is the local agency for American aid, meddles with not only the CEB policy suggestions and decisions, but also the daily operation and management of each and every project. (No, 1989, p. 66)

It is certainly true that even under ECA, the US authorities were very strict about the conditionalities of bilateral aid to South Korea. Secretary of State Dean Acheson himself gave a warning via the US Embassy that the ECA aid would be reduced or even canceled should the South Korean government fail to stem the tide of inflation. ECA was supposed to provide aid for economic reconstruction, and yet 48% of its counterpart fund was transferred to the general account for fiscal stabilization whereas only 5% was set aside for reconstruction projects (Kim, 1986, pp. 245-246). The laser-like focus on economic stabilization continued under MSA just as well. Although Article 3-12 of the Meyer Agreement stipulated to “provide logistic support to the armed forces of the Republic of Korea to the maximum extent feasible,” the priority was definitively given to stabilization ahead of such an open-ended commitment:

Article 1-4-b. It is an objective of the parties to increase the capabilities of the Republic of Korea for economic self-support so far as is possible within the limits of available resources and consistent with the attainment of fiscal and monetary stability.

Article 3-7-d. To use the special account established in [the Bank of Korea] to the maximum extent possible as a stabilizing device and as an offset to harmful monetary expansion.

In other words, ‘defense support’ under MSA did not necessarily mean aid transfer to the recipient’s defense spending; rather, it should be broadly interpreted to include stabilization of the recipient’s national economy so that it does not collapse under the weight of ‘overdeveloped’ armed forces such as South Korea’s. Once again, therefore, where to draw the line between military and economic aid turns into a knotted puzzle in the US-South Korea relations.

2. Guns over rice: burden of defense spending on South Korean fiscal policy

Some of the critics of American aid policy to South Korea might have mischaracterized economic assistance under MSA, but they were not wrong about the excessive fiscal burden of the South Korean military forces. Security-related spending dominated the budget from the very beginning of the Republic of Korea. In 1949, defense alone accounted for 26.3% of the total government spending. Given the internal political turmoil with armed insurrections prior to the war, the astounding 12.3% spending on law enforcement should be also added to the security-related spending that consumed nearly 40% of the entire budget, half of which was financed by simply printing money. Despite stringent conditionality of ECA, enormous fiscal deficit and inflation was inevitable, and the American aid could only make up for pitiful 0.2% of the revenue (Kim, 1967, pp. 50-53).

〈Table 3〉 South Korean defense expenditures, 1949–1963 (million KRW)

Fiscal Year	Defense expenditures	% of GNP	% of total expenditures
1949	24		26.3
1950	132		54.5
1951	330		53.9
1952	946		44
1953	3,261	7.8	53.7
1954	5,987	10	42.1
1955	10,638	10.4	37.8
1957	11,246	6	32.1
1958	12,732	7	31.0
1959	13,920	7.1	34.8
1960	14,707	6.7	35
1961	16,599	6.4	29
1962	20,474	6.8	23.2
1963	20,479	5.1	28.1

Source: Kim (1966, p. 132)

Needless to say, defense spending soared during the wartime, and never dipped below 30% until 1961 - not because it stopped rising, but because the total expenditures rose even faster that year. Whether it is per total spending or per GNP, South Korean military spending was second only to the US in the aftermath of the Korean War.

On top of it all, wartime hyperinflation had much to do with the 1950's agreement that South Korea would loan the operational costs incurred by the UN Forces in domestic currency. This was done entirely by increasing money supply since the Bank of Korea had to provide cash upon request from the UN Command without sufficient reserve. By one estimate, as much as 70% of the increase in money supply between 1951-1952 was attributed to this policy that helped cause massive inflation (Lee, 2002, pp. 208-212). The point of the wartime aid programs described earlier - CRIK, UNKRA, and others - had to be repaying these high costs of military operations. But the repayment process was painfully slow and less than half the amount was delivered on time, making the currency withdrawal effect very low. While the Meyer Agreement resolved the issue in principle, the delay of repayment continued to exert inflationary pressure upon the economy (Kim, 1967, p. 62). Moreover, the agreement that the repayment was to be made in USD gave rise to the long, acrimonious wrangling over the exchange rate between the US and the Korean officials in the CEB (Lee, 2002, p. 62).

From the perspective of the South Korean officials, American aid was not a gift or benefit, but a delayed loan repayment even though they were in no position of power as a creditor. Adding insult to injury, the Americans demanded the South Korean government to get its fiscal house in order, which forced its hands to increase domestic tax revenue, thereby putting the burden of wartime military spending squarely on the already suffering populace (Kim, 1967, p. 69).

As the programs under MSA had finally started kicking in since 1953, foreign aid became the biggest revenue source of the South Korean government by 1957. However, the chronic fiscal deficit did not go away because of the overgrown military and other security-related expenditures;

it had to be made up for by monetary infusion and bond issue since the counterpart fund was not very effective in tamping down the fiscal deficit (Kim, 1967, pp. 76-77). Even so, key Korean participants in the CEB, such as Song Insang and In Taesik recalled that the Americans at the CEB were adamant about the counterpart fund used for defense expenditures only (Gong, 1992 pp. 17-19). The CEB's austerity policy suppressed all other expenditures except for defense.

As shown in Table 3, there was a steady increase in defense spending - and other security-related expenditures - throughout the 1950s. The budget for economic reconstruction obviously suffered from this security-first policy of the CEB. The South Korean government tried to jump-start economic reconstruction and development through fiscal loans and investments, of which the major financial source was the counterpart fund. However, this ambitious effort was largely crowded out by defense expenditures (Kim, 1967, pp. 85-89; Lee, 2002, pp. 399-402). Still, fiscal loans made by the Korean Industrial Bank benefited 40 out of the 89 biggest manufacturing firms, contributing to the brief economic boom in 1957 when the counterpart fund reached its peak level (Gong, 1992, p. 53). Here we can entertain another counterfactual - had the counterpart fund used less for defense expenditures, more capital would have been spent in economic development projects through fiscal loans and investments.

Finally, the burden of military spending was also related to the agricultural sector. The food aid under Public Law 480, introduced in 1956 as one of the MSA aid programs, dumped cheap surplus American grains on the South Korean market. It exacerbated the downward spiral of the South Korean rural economy, and the bumper-crop year of 1958 made matters even worse by plunging the entire economy into a recession. But the blow PL 480 dealt to South Korean farm villages was only one side of the story. Another side was that the revenue share of the South Korean government from the food aid sales was almost entirely transferred to the defense expenditures (Hong, 1964, p. 317). The burden of military spending weighed heavily on all sectors of the South Korean economy.

3. The Impact of military aid: did it reduce the burden of defense support?

So far, I have relied extensively on the literature regarding American aid. Military aid, on the other hand, has been only given passing mentions in the same literature. I suspect that the reason is not one of oversight, but of inaccessibility to relevant data. For instance, the South Korean military does not appear to have kept the data on research and development costs until 1974 (Ham and Yun, 2002, p. 130). Available data are mostly about “uncontrollable expenditures” on procurement, personnel, operations and maintenance. The scale of military aid to South Korea under MSA and FAA was unavailable as late as 1989, except for a few aggregated figures in some of the references. For now, USAID publishes year-to-year overall military aid figures on its website. Although the data lack the detailed accounts for the military aid, they render some interesting observations with regard to the impact of military aid on South Korean economy.

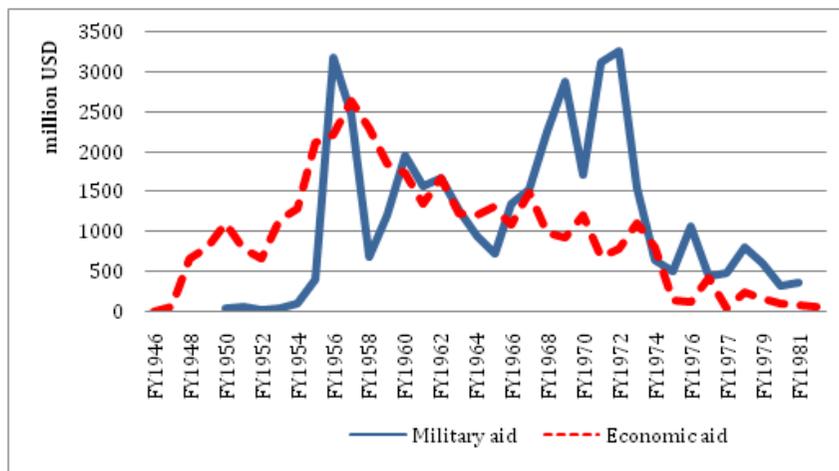
First of all, the defense budget until 1964 was wholly dedicated to the uncontrollable expenditures, and today they still account for 70% of the budget because the South Korean armed forces have maintained more than 600,000 troops since 1954. Thus, it should be noted:

The South Korean defense budget is only part of the total expenditures on national defense. The budgetary spending partially covers maintenance costs for the military personnel and already acquired equipment. The rest of the maintenance costs, and the entire spending on new weaponry and equipment to improve upon military strength are entirely dependent upon direct military assistance from the US. (Kim, 1967, pp. 134-135)

From this, we can deduce that the size of military aid was very likely to affect the amount of military transfer from the counterpart fund. Figure 1 illustrates that the military aid under MSA indeed rose very sharply,

between FY 1956 and 1957 in particular, topping all economic aid programs combined. Military aid substituting for the ‘defense support’ function of economic aid appears to have existed during this time period when defense expenditures lost much of their upward momentum (see Table 3). Simply put, a large portion of the US military aid was spent feeding and clothing the South Korean soldiers. This was one of the issues discussed during the negotiation between South Korea and the U.S. over the transfer of military assistance program and the reduction of South Korean forces in 1959 (Kim, 2013).

[Figure 1] US military and economic aid to South Korea, 1946–1981 (constant 2012 USD)



Source: USAID

Another data source claims that the share of the US military aid in South Korean defense expenditures was over 80% in the immediate postwar years and then gradually reduced to about 60% by 1960 (Ham, 1998, p. 206). Despite some incongruence with the official USAID data, this source suggests that the US military aid was often much bigger than the official South Korean defense budget.

It is also interesting to note that except for the unusual dip in FY 1958, military aid maintained a relatively high level above one billion USD (in

2012 constant) until the end of MSA and beyond. While it would be unwise to extrapolate these preliminary findings to the next period since FAA changed the essence of economic aid from in-kind grants to concessional loans, South Korea's continued path to development into the 1970s hints at an enduring economic impact of military assistance. In the final analysis, Wolf's "resource addition" view seems to hold true in the South Korean case as he claims, "the effect of military aid may well be to release resources for development purposes. And reductions in military aid may well result in diminished resources for development" (Wolf, 1972, p. 5).

III. Concluding remarks

The irony in exploring the economic effect of military aid while at the same time analyzing the 'defense support' function of economic aid is in itself a reflection of a series of contradictions the country made slogans out of: "fight on one side and build on the other" and "stability and reconstruction".

We would probably need much more detailed data on the real defense spending funded by the South Korean budget as well as American military aid before making a firm conclusion about their economic impact. One thing is certain, however - the maintenance of large military forces was a drag to the economic recovery and reconstruction in South Korea, be they the UN forces during the war or the national army after the war. It was under these circumstances that the American military aid helped ease the fiscal burden of South Korean defense spending, facilitating public investments in economic development.

How about the role of military aid in the following decades? One can plausibly make an argument that it contributed to the establishment of strong state security apparatuses and the rise of the military regime, which paved the way for high-speed development from the 1960s onward.

Although the “guns-versus-butter” trade-off research on South Korea found that defense spending had either a negative or no significant effect on economic growth under the military regime (Moon and Hyun 1992; Park 1993), still it might well have continued to produce the same indirect effect of “resource addition” by lessening the fiscal burden of South Korean military spending as the massive US military aid continued well into the 1970s.

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〈국문요약〉

한국의 전쟁 후 경제 재건에 미친 미 군사원조의 효과에 대한 연구

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1953-1960년의 전후 재건기 동안 한국 경제는 미국 원조에 크게 의존하고 있었다. 미국의 시각에서는 군사원조든 경제원조든 간에 한국의 국가안보를 유지하는 것이 대한 원조의 일차적 목적이었는데, 이 점은 미국 상호안보법에 의거해 공여된 재건기 원조에서 가장 뚜렷이 드러난다. 정전 직후 전체 원조액의 40%를 넘어섰던 군사원조는 이 시기에 전반에 걸쳐 20%를 상회했으며, 공법 480조에 의거 도입된 미국의 식량 및 농산물 현물 원조 또한 대총자금을 거쳐 상당부분 한국 국방예산으로 전용되었다. 이러한 국방 우선 정책은 1950년대의 경제 재건 및 발전을 위축시켰다는 비판을 받아왔다. 그러나 이 논문에서는 가용한 역사적 자료를 토대로 국방 목적으로 전용된 경제원조의 규모를 군사원조가 경감시킨 측면이 있음을 보여줌으로써, 경제 재건에 군사원조가 간접적인 기여를 했음을 주장한다.

주제어: 군사원조, 경제원조, 경제 재건, 국방, 개발