

Abstract: This paper sets up a small open two agents new Keynesian (TANK) economy model with Ricardian (unconstrained) households and Keynesian (constrained) households and addresses the effect of redistribution policy on the economy. The paper shows that Ricardian equivalence does not hold in the small open economy with two agents, irrespective of the degree of nominal price rigidities, contrasting to Bilbiie et al. (2013). The effects of both the pure redistribution policy from Ricardian households to Keynesian households and debt financed uniform tax cuts critically depend on the type of monetary policy. Under a Taylor rule reacting to expected future inflation, the real exchange rate does not respond to a pure temporary redistribution policy, while it depreciates to debt-financed uniform tax cuts, if debt stabilization is not scheduled into far future.