
Bridging Regional Inequality in Indonesia: an Endogenous Growth and Structural Transformation Perspective

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ABSTRACT

Regional development in Indonesia is still facing challenges such as regional inequality, disparities in the quality of human resources, and access to digital testing. This research aims to analyse strategic issues in regional development with a focus on GDP movement, HDI, and the digital divide. The approach taken is a literature review of reputable academic sources, reports from international organisations (UNDP, OECD, ADB), and empirical national data. To build the theoretical basis from this data collection, New Economic Geography is used as a grand theory, supplemented with the application of endogenous growth theory to clarify the role of innovation as human capital. The results of this study demonstrate that areas with better infrastructure, education, and digital resilience are able to grow more quickly and have a greater potential for better integration into the economic system; conversely, areas that are lagging in terms of infrastructure, education, and digital resilience will be pressured in their development. This disparity is felt more acutely post-pandemic. These findings underline the need for location-based development policies, strengthening regional governance systems, and more effective fiscal decentralisation policies, culminating in a more inclusive digital governance system. In conclusion, sustainable regional development can only be achieved through strategies that emphasise location-based development, enhancement of human resource quality, and the utilisation of technology in integrated economic development.

Keywords: regional development, regional inequality, HDI, digital transformation

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INTRODUCTION

In regional economics, economic development remains strategic within the field of development economics, especially within large archipelago countries like Indonesia which faces heterogeneity in its geography, resources, and population structure. Patterns of economic activity concentration within certain regions, while others remain stagnant, highlight the classical relevance of cumulative causation (Myrdal, 1957) and core-periphery (Krugman, 1991) models within contemporary Indonesia. Recent official data shows the Island of Java's dominance in the formation of the gross domestic product (GDP) of the nation in 2024, where Java contributes 57.02% of Indonesia's GDP, followed by Sumatra at 22.12% and other regions much lower (BPS, 2025). This evidence indicates the persistence of the concentration of economic and market activity, which affects the level of employment, productivity, and the fiscal capacity of the region.

From the perspective of macro dynamics, the report of the Indonesia Economic Prospects (IEP) of the World Bank emphasizes that Indonesia's growth rate is still around 5%, with the potential for external weakening and the need to strengthen the foundations of productivity and the quality of public spending in order to propel more equitable, structural shifts across regions (World Bank, 2023, 2024). Fiscal policy is also expected to remain within the confines of a deficit below 3% of GDP; however, the financing of the social and infrastructure agendas places demands on revenue side reform and more effective spending prioritisation to the lagging regions (World Bank, 2024). In this context, the urgency of a policy mix that meets the dual challenge of maintaining macroeconomic stability while sustainably reducing regional inequality is underscored.

Although dominated by inequality and differing positions of subjects, empirical evidence gives us insights into what can now sustain or even strengthen subjects that are characteristic of club convergence, or subjects that can be grouped within an inequality that has a profile trajectory in line with doing clusters convergence, the complexity of growth. One example of such subjects is the growth of centres that do not interact and are not supported by connectivity mapping and spatial governance planning. One example of non-interactive inequality is spatial inequality, while the growth of centres is supported by connectivity mapping and spatial governance planning. One example of collective spatial inequality and non-interactive inequality is regional inequality that is spatial in nature. An example of a collective spatial characteristic is collective inequality and regions that share public services with coordinated subjects. Implementation in relation to spatial matters is the distribution of coordinated subjects within an area defined by an economic corridor.

Issues related to the framework of subjects that are not spatial in nature, such as the example of collective spatial inequality. A spatial framework inequality that is collective with collective spatial inequality. One form of inequality is caused by roads accessible to areas surrounding those roads. A collective road framework. The issue related to subjects in areas integrated with the market can be categorised in stability as a single inequality that is of a framework nature. One form of inequality that may obstruct as a framework spatial inequality is inequality in distribution structure that is collective. Both

findings produce infrastructure with area-based inequality and result in a framework that is spatial. Where collective spatial infrastructure is of a distribution nature.

At the same time, the digitally driven economy is also posing the risk of ‘new-form inequalities’. The fast of annual-report digital economy is also growing and is seen as one of the elements driving the productivity and market opportunities of micro, and small enterprises. However, the gaps in ICT infrastructure, digital literacy, and the use of productive applications create a digital divide. A study of 460 districts/municipalities shows a clear spatial imbalance of digital household and individual residents with a concentration of access and use of more advanced (skills) regions (Kartiasih et al., 2023). As a matter of policy, the World Bank puts emphasis on the agenda of universal connectivity, digital more advanced than the rest of the regions. World Bank, 2021). These findings and recommendations were echoed in the latest National Internet Penetration Survey that shows inter-region deviation; and emphasises the need for more focused interventions for the least developed areas (APJII, 2024).

The dimensions of sustainable development are increasingly becoming part of the development of the region. The agenda of decarbonisation and green growth requires the reorientation of public/private investments to consider the quality of growth. The draft of the energy transition policy of the OECD (2021) points out the need for mobilising private funds and policy reforms to enable the substitution of renewable energy and energy efficiency in Indonesia. At the national level, the latest study on inclusive green growth proposes a composite index designed to measure and evaluate the performance of provinces on three pillars of growth, social equity, and environmental sustainability, as well as the efficiency of public spending, to assess the performance of provinces. Meanwhile, the Human Development Report (2023/2024) puts Indonesia in the global development ‘deadlock’, characterised by inequality and polarisation. This emphasises the need for policy coherence across SDGs (including inequality reduction) (UNDP, 2024).

By combining three main lenses, namely (i) regional inequality and club convergence, (ii) digital transformation and the ICT gap, and (iii) inclusive green transition, this article seeks to provide an updated and relevant literature review and policy framing for Indonesia. First, we summarise evidence, mostly post-decentralisation, on the persistence of disparity and the role of inter-regional governance, including cross-country evidence that is paradoxically used as practical benchmarks. Second, we have synthesised the most recent findings on the digital economy at the district/municipality and MSME levels to identify adoption bottlenecks and design place-sensitive interventions (e.g., last-mile connectivity, skills upgrading, and logistics services). Third, we have analysed the frameworks and indicators for inclusive green growth to identify policy tracking gaps at the provincial/district levels, particularly on the integration of resource-based industrialisation with environmental impact mitigation and social resilience enhancement.

This article contributes in three respects: Conceptual contribution, by integrating the literature on spatial inequality, the digital economy, and green growth, and amalgamating it into one coherent framework for regional development in Indonesia.

Empirical contribution through the synthesis of findings for the years 2020-2024 (and the most recently released statistics) focusing on key indicators (contribution of GDP by island, digital indicators, spatial inflation, access to infrastructure) to articulate policy-relevant insights. Contribution to policy, in the form of a regional policy action agenda that balances hard infrastructure (roads, ports, ICT backbone) with soft infrastructure (local government capacity, digital skills, innovation ecosystem) and finance for pro-chronically lagging regions energy transition.

Overall, the latest evidence indicates that lack of targeted interventions (place-based, collaborative, and green) inter-regional inequalities are at risk of remaining, or worse, transforming into newer forms (e.g., digital gaps). Thus, the policy for the Regional Development of Indonesia must focus on: (1) Strengthening physical and digital connectivity that reduces market access gaps; (2) Collaborative cross-border governance for public investment and essential service supply coordination; and, (3) Pro-inclusive green policy design so that resource-rich regions do not fall into a cycle of resource-inefficient and unjust intergenerational development.

THEORETICAL FRAMEWORK AND EMPIRICAL STUDIES

New Economic Geography (NEG)

New Economic Geography (NEG) by Krugman (1991) is the main building block in attempting to explain the phenomena in the development of the economy of a region. This theory emphasises that the concentration of economic activity is not random. Rather, it is explained by the combination of agglomeration, transport costs, and economies of scale. The lower the costs of transport and the greater the benefits of agglomeration, the stronger the tendencies of economic activity to agglomerate in a particular focal point of growth.

In the case of Indonesia, NEG explains why Java Island is still the epicentre of economic growth, while the regions outside of Java continue to be economically stagnant in attracting investments and developing industries. More recent studies show that economic agglomeration does increase a region's productivity, but at the same time also increases the disparities between regions (Nguyen et al., 2023; Zhao et al., 2022). This explains why such theories help understand the paradox of economic development of a region, which is the gap and growth.

Cumulative Causation

In support, the cumulative causation theory of Myrdal (1957) explains that the development of an area produces two main effects: spread effect (positive impact of investment, technology and knowledge flowing into a new region) and backwash effect (negative impact of human and capital drain from the region).

The sub-location phenomenon of the backwash effect occurs in developing countries, and in Indonesia particularly, is quite concerning. This is reflected in the active migration of skilled labour to various major cities, and the imbalance in the distribution of

digital education infrastructure and higher education outside the central regions. This inequity is also addressed in the research by Surbakti et al. (2021) and Wicaksono & Narjoko (2020) which indicates the weakening spread effects of development in Indonesia, and this phenomenon further reinforces the inequity noted in Surbakti et al. (2021) and Wicaksono & Narjoko (2020).

The combination of NEG and Myrdal's theories can also help explain this phenomenon. NEG provides an adequate explanation for the spread of Myrdal's theory, while Myrdal offers insight into a more equitable disparity and the repetition of gaps. This merging makes NEG and Myrdal a thorough framework to parse the economics of regions. Thus, the two have become the building blocks to understand the contemporary issues of regional development in Indonesia in the digital age and post-pandemic.

RESEARCH METHODS

A literature review with the keyword 'regional economic development in Indonesia' has been analysed with an understanding of the development of a systematised literature review method. This method facilitates the synergising of empirical and conceptual findings from numerous sources as it provides an understanding of regional disparity, digital divide, and inclusive development.

Strategy of Collecting Literature

Literature has been collected from Scopus, Web of Science, Science Direct, Taylor & Francis, and Springer Link, as well as the national database Garuda and Neliti. The keywords used to search include 'regional development', 'regional inequality', 'Indonesia economy', 'digital divide', 'digital economy', 'inclusive growth and development'. In order to ensure up to date information, we have adapted literature to be published between the periods of 2020-2024 with seminal literature from Krugman, 1991, and Myrdal, 1957, as the theoretical frameworks to be used.

Analytical Framework

An analysis has been conducted using thematic analysis as suggested by Braun and Clarke in 2006 by sorting the findings of the literature from the identified major themes, namely:

- a. Disparities in GDP and regional productivity
- b. Quality of development and human capital with respect to social (IDP, education, and health)
- c. Digital transformation and the inaccessible technological divide
- d. Policy of regional development (fiscal decentralisation, development of eastern Indonesia, digital economy roadmap)

This method has allowed the authors to detect imbalances, similarities, and patterns, as well as to show the contributions of the new studies to the regional economic development discourse.

Validity and Reliability

“To ensure the study's validity, the source triangulation technique was employed by comparing findings from international journals, BPS official data, and government policy papers. Reliability is maintained by systematically noting all the sources utilised and composing a reference list.” With regard to the limitations, this study is a research review and hence does not present primary field data. In this case, however, depending on the most recent literature and official data, this paper is able to offer a substantial conceptual understanding, as well as precise policy proposals pertaining to Regional Economic Development within the territory of Indonesia.

RESULTS AND DISCUSSIONS

The development of regional economies in Indonesia continues to face the challenge of inter-regional imbalances. Despite the national economy having stable growth after the COVID-19 pandemic, the growth is not equitably distributed. As BPS (2023) illustrates, there is still a dominance of the national economy in Java, which contributes over 57% of the national GDP, while Maluku and Papua contribute just about 2.5%. This illustrates the relevance of Myrdal's (1957) cumulative causation theory, which states that more developed regions have a stronger pull on resources and investments, thereby widening the gap with underdeveloped regions.

Imbalances in GDP and Economic Structure

Among the factors that characterise the imbalances in regional development, imbalances in GDP are the most significant. The dominance of Java in the national economy contributes to the national economy through the concentration of industrial agglomeration, more advanced transport infrastructure, and proximity to key markets. It was found by Kuncoro and Murbarani (2023) that the bigger cities, particularly Jakarta, Surabaya, and Bandung, play a central role as a hub for manufacturing, financial services, and technology. This agglomeration effect gives rise to a productivity premium that is unmatched by other regions.

In contrast, the East Indonesia region with an agrarian economy base is still trapped in a low productivity trap. The transformation of the primary sector into the secondary and tertiary sectors is slow. The World Bank (2021) emphasises that the slow pace of industrial development in the outer Java region is due to lack of access to capital, low logistical connectivity, and limited energy infrastructure. This is exacerbated by the high inter-regional transport costs, resulting in a low competitiveness of products from remote regions.

Area analysis indicates that the pattern of this agglomeration has an impact on the district level as well. For instance, Amelia, R., & Prabowo, P. S. (2022) shows that “Bojonegoro Regency is the center of growth, with facility units being 1969.” This underscores that the higher the concentration of these facilities, the more the economic activities of the growth center.

Also, the shift-share analysis of this study shows that “Lamongan Regency has most considerable competitive advantage, manufacturing sector has differential shift 662289.02” (Amelia, R., & Prabowo, P. S. 2022). This implies that the disparity of the economic structure is not only inter-island, but also inter-district.

With respect to the economic structure of the region, the study of Wijaya, GC (2022) found that “Badung Regency has not experienced a shift in the economic structure during the COVID-19 pandemic” shows the resilience as well as stagnation of the sector within the region depending on tourism to transform.

Empirically, Rahman et al. (2022) estimated that the difference in GDP per capita across provinces in Indonesia is still affected by more than 60% of spatial factors, including proximity to an economic centre. These findings show that without strong affirmative policies, the economic inequality in terms of GDP will likely continue.

This phenomenon is in line with the Endogenous Growth Theory (Romer, 1994) which underlines the importance of human capital, innovation, and technological accumulation in driving sustainable long-term growth. In regions with high-quality education, the economy is accelerating.

In addition, the pattern of economic concentration in Java is also in line with the New Economic Geography (Krugman, 1991) framework, where the agglomeration effect creates a new growth centre, but at the same time, it widens the gap between the centre and the periphery. Recent studies by Fujita and Thisse (2022) also confirm that infrastructure connectivity determines the strength of spillovers between regions.

Development of Social Capital and Human

Apart from economic indicators, the aspects of human development as one of the aspects of regional development are of utmost importance. Human Development Index (HDI) shows a clear disparity, where DKI Jakarta and Yogyakarta are above 80 (high category) while Papua and West Papua are still below 70 (low category) (BPS, 2023).

The difference in the HDI of the provinces shows the inequality in education, health, and the standard of living, which strengthens the arguments of the Endogenous Growth Theory that human capital is a key factor of sustained growth (Lucas, 1988; Romer, 1994). Regions with a high HDI are more likely to have a greater capacity to adopt new innovations and enhance regional productivity.

On the other hand, the unequal distribution of health and education services makes more pronounced the role of New Economic Geography which states that areas with centralised public amenities are more likely to attract migration and investment, thus widening the gap between regions (Krugman & Venables, 1995). Recent research by Crescenzi & Iammarino (2022) has also shown that the unequal distribution of human resources is a limiting factor to the spatial integration of underdeveloped countries.

This disparity has a direct impact on the poor local human resources who are unable to participate in the modern economy. Suharto (2022) explains how the poor access to quality education and health services in underdeveloped areas undermines social mobility. This is also exacerbated by the poor levels of digital and financial literacy.

Other than Human Resources, social capital is also considerable. The most recent research by Firmansyah and Fitriani (2021) discovered that regions with strong social trust and community cooperation traditions tend to demonstrate better capacity for fostering local economic initiatives. However, in conflict regions, such as Papua, the weakness of social capital due to distrust towards the state obstructs the effectiveness of development policy.

Thus, the policy of human development, in this case, also requires investments in social capital to be strengthened by the community and the development of local, credible, social institutions.

Digital transformation and Digital Divide

Digital transformation is at the forefront of the challenges encountered in the development of the regional economies. The Covid-19 pandemic catalysed the use of digital technology in commerce and the provision of educational services, and even in public service. However, digital inter-regional gaps still exist. APJII (2023) reports that internet penetration in Java is 82%, while in Papua and Maluku it is only around 48%.

This gap does not only limit access to information but also constrains economic opportunities. Regions with low digital connectivity are also likely to be far behind in the development of digital services, e-commerce, and even Financial Technology (Fin-tech) services. Fitriani and Hofman (2023) assert that the digital divide, in today's world, is a primary factor in regional disparities in Indonesia.

Infrastructure development in general is implemented for various purposes, but in terms of digital infrastructure development, it has a different allocation. According to Zhao et al. (2022), digitalisation offers a range of innovative enhancements to the productivity of SMEs, improved global market mastery, and increased efficiency at various levels of bureaucracy. Hence, it is essential to understand that the development of internet networks in previously lagging locations should be seen as an intersection and investment in development, not merely as a project for infrastructural development.

Likewise, there needs to be attention towards the development of digital infrastructure, particularly concerning the development of digital literacy. Especially in relation to digital infrastructure development, the general digital literacy of the public needs to be improved. This is influenced by the fact that the community will only become passive users of technology and will not be players in the digital economy. Therefore, digital training programmes for SMEs and the younger generation in lagging areas, and those applying information systems and technology, become urgent matters.

Regarding the gap in internet access and digital literacy between regions in Indonesia, it introduces a new dimension for regional development. In this case, it is closely related to learning growth theory, digital innovation, and modern technology viewed as long-term growth engines. On the other hand, the internet penetration of a region fundamentally amplifies the economic productivity of that region, particularly in the digital economy, as well as for micro businesses, expanding the region's financial inclusivity (Banga & te Velde, 2021). Under the new economic geography, the digital

divide indirectly increased the economic geography of the region, particularly in urban centres and peripheral regions.

This corresponds with the 2022 findings of ADB, that the digital divide has the potential to increase the inter-regional disparities if the adjustment of policies for equalising digital infrastructures in the regions is not in the systems.

Regional Development Policies

The government of Indonesia formulated policies for Regional Development in the RPJMN 2020-2024 focusing on three main areas: the construction of infrastructure, improvement of human resources, and digitisation. However, there are still overriding challenges related to the implementation of these policies.

First, in regard to infrastructure, National Strategic Projects (PSN) such as the construction of toll roads, ports and airports are still mostly concentrated in the islands of Java and Sumatra, which tend to strengthen the imbalances. Nasution et al. (2021) have reported that policies on the construction of infrastructure tend to overlook the policies on the construction of infrastructure to enhance inter-regional mobility, particularly those regions that are hinterlands to growth centres.

Second, Then, from the point of view of finance, the decentralization that occurred in 2001 should be observed as the time of the region to manage development on their own. However, Wijayanti and Arsyad (2021) shows that the fiscal dependence of the regions towards transfers from the centre is still very high, as a result the innovation of fiscal value of the regions is very weak. The effectiveness of fiscal policy is also proven in Arifin, A. and Azizah, S. N. (2022), where the researchers explicitly stated that “DAK has an effect on Human Development Index, while DAU and DBH have no effect”. This is an empirical evidence that the policy on specific allocation is more targeted in fostering development..

Third, the Policy on Digital Transformation in the other areas has been very effective only in the large urban centres while the rural areas still face challenges. The Asian Development Bank (2022) points out that the integrated development of infrastructure, human resources training and a regulatory ecosystem that facilitates innovation are the prerequisites for the successful Digital Transformation.

The Indonesian regional development policies balance the economic growth of the country against the decreasing of the economic growth of the gaped regions. Endogenous Growth theory suggests that policies should concentrate on long term investments directed towards education, research, innovation, and technological adoptions, as posited by Romer (1994) and Lucas (1988), who state that the increase of human capital will spill over the growth of a region.

An example of the implementation of this theory is the Indonesia Digital Roadmap 2021–2024, which aims to strengthen the human resource-based digital economy ecosystem. Regions with high capacities in education and digital infrastructure will benefit more quickly from the transforming economy as a new growth engine (World Bank, 2023).

Additionally, from the perspective of New Economic Geography (Krugman, 1991; Krugman & Venables, 1995), a major focus of regional development policies should

address the concentration of economic activities in growth poles of a region. In the case of Indonesia, the over-dominance of Java as an industrial and trading centre is leading to strong agglomeration effects, and is also widening the gap with the eastern Indonesia region. Thus, policies like the development of the Ibu Kota Nusantara (IKN) as well as the interconnected region infrastructure development programme can be seen as a redistribution of economic growth. Furthermore, ADB (2022) emphasises the need for the development of connectivity that is digital and not just physical. Without equal access to the Internet and the lack of digital literacy, any efforts to develop a region are likely to exacerbate the digital divide. This is echoed by UNDP (2024) stating that inclusive development policies need to strike a balance between a growth-driven policy and an equity-driven policy.

It can, therefore, be concluded that, for the case of Indonesia, policies relating to the development of a region must seek to improve the following two key dimensions.

- 1) The strengthening of human capital and innovation (Endogenous Growth Theory) via education, research, and digital literacy.
- 2) The reduction of spatial disparity (New Economic Geography) via the construction of physical and digital infrastructure that link growth poles with the periphery.

The combination of the two sets of theoretical framework gives the primary development of a region within the context of Indonesia an innovative and inclusive character, so that the benefits of economic growth are enjoyed by all.

Synthesis of Findings

This study indicates that in Indonesia, the development of a region is not only determined by the infrastructure, but also by the quality of Human Resources and readiness in Digital. The Endogenous Growth Theory emphasizes the importance of investment in education, new knowledge, and innovation, while the New Economic Geography focuses on the need for a strategy to minimise spatial disparity through inter-region connectivity. The following are the three major conclusions:

- a) The disparity in GDP and economic structure is still dominantly caused by industrial agglomeration and infrastructure gaps.
- b) The potential of the region to adapt to an economic transformation is determined by the level of human development as well as social capital, but the gap in the Human Development Index is still significant.
- c) The potential of transformation digitally is both an opportunity and a challenge. Without inclusive policy, digitisation will deepen the disparity of regions.

As such, development policy must be a fusion of human capital strengthening and the dispersal of growth centres to achieve equilibrium in development. This is in accord with the OECD's (2021) and UNDP's (2024) recommendations that the integration of regional policy must focus on innovation, inclusion, and connectivity.

CONCLUSION, SUGGESTION, AND LIMITATION

Indonesia's regional economic development is currently at a crucial crossroads. On one hand, there have been significant achievements such as relatively stable GRDP growth, improvements in the human development index, and the expansion of digital infrastructure as the backbone of a new economy. On the other hand, large disparities persist across regions, which remain a major obstacle to the vision of Golden Indonesia 2045. As shown by data and various studies (World Bank, 2023; Bappenas, 2023; Rosyadi & Widodo, 2023), these inequalities are not only economic in nature but also multidimensional, encompassing education, health, and access to digital technology.

Theoretically, this study highlights the relevance of endogenous growth theory as a core framework for explaining the role of human capital, innovation, and technology as drivers of regional development. Meanwhile, dependency theory is used as a critical lens to understand why resource-rich regions remain trapped in low-competitiveness economic structures. Integrating these two perspectives illustrates that regional development requires not only greater accumulation of production factors, but also structural transformation, stronger institutions, and a more equitable distribution of development benefits.

From a policy perspective, this study emphasizes three key implications. First, transportation and digital connectivity across regions must be strengthened to facilitate market integration and ensure a fair distribution of development gains. Second, the provision and enhancement of human capital, especially in lagging regions should be prioritized so that workers in all areas have equal opportunities to participate in an increasingly knowledge-based and digitally transformed economy. Third, central and local governments need to improve collaboration in fiscal policy and development planning to avoid excessive dependence on certain regions particularly Java in driving balanced national growth (Nugraha & Lewis, 2021; Aritenang, 2022; Tambunan, 2022).

From a practical standpoint, this study can serve as a reference for regional policymakers, academics, and practitioners in designing more inclusive and sustainable development programs. Leveraging local potential integrated with digital technology should aim to reduce regional development disparities. Furthermore, development strategies must consider contemporary issues, such as the growing global and national focus on energy transition, environmental sustainability, and the green economy (OECD, 2021; ADB, 2022).

Limitations

As this study is a literature review, it does not present primary field data. However, it depends on the most recent literature and official data; thus, this article is able to offer a substantial conceptual understanding as well as precise policy proposals related to Regional Economic Development in Indonesia.

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