**What Is Money?**

Money makes the world go round. Economies rely on the exchange of money for products and services. Economists define money, where it comes from, and what it's worth. Here are the multifaceted characteristics of money.

**Medium of Exchange**

Before the development of a medium of exchange—that is, money—people would barter to obtain the goods and services they needed. Two individuals, each possessing some goods the other wanted, would enter into an agreement to trade.

Early forms of bartering, however, do not provide the transferability and divisibility that makes trading efficient. For instance, if someone has cows but needs bananas, they must find someone who not only has bananas but also the desire for meat. What if that individual finds someone who has the need for meat but no bananas and can only offer potatoes? To get meat, that person must find someone who has bananas and wants potatoes...and so on.

The lack of transferability of bartering for goods is tiring, confusing, and inefficient. But that is not where the problems end: even if the person finds someone with whom to trade meat for bananas, they may not consider a bunch of bananas to be worth a whole cow. Such a trade requires coming to an agreement and devising a way to determine how many bananas are worth certain parts of the cow.

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**Electronic Money**

**What Is Electronic Money?**

Electronic money refers to money that exists in banking computer systems, which may be used to facilitate electronic transactions. Although its value is backed by fiat currency, and may, therefore, be exchanged into a physical, tangible form, electronic money is primarily used to transact electronically, due to the sheer convenience of this methodology.

**BREAKING DOWN Electronic Money**

Electronic money is used for transactions on a global basis. While it may be exchanged for fiat currency (which incidentally distinguishes it from cryptocurrencies), electronic money is most commonly utilized through electronic banking systems and monitored through electronic processing. And since a mere fraction of the currency is utilized in physical form, the vast percentage of it is housed in bank vaults and is backed by central banks. For this reason, a primary function of the U.S. Federal Reserve and its 12 supporting banks is to manage the fiat currency in physical form and control the money supply through monetary policies and open market operations.

**Important: [Electronic money is backed by fiat currency and may be exchanged for physical cash, but it is most often seen in electronic usage.]**

**Currency in Circulation**

Electronic money can be held in various places. Most individuals and businesses store their money with banks that provide electronic records of the cash on deposit. However, prepaid cards and digital wallets like PayPal and Square likewise let users deposit fiat currency for electronic money.

**Electronic Payment Processing**

Many Americans process transactions electronically in a multitude of ways, such as:

* Receiving paychecks through direct deposits.
* Moving money from one account to another via electronic fund transfers.
* Spending money with credit cards and debit cards.

While physical currency is still advantageous in certain situations, its role has gradually diminished over time. Many consumers and businesses believe electronic money is more secure and convenient because it cannot be misplaced, and it is widely accepted by merchants nationwide. The U.S. financial market has consequently established a robust infrastructure for transacting the electronic money, which is primarily facilitated through payment processing networks, such as Visa and Mastercard.

Banks and financial institutions partner with electronic money networking processors to issue their customers branded network cards that facilitate the electronic transactions, from bank accounts to merchants. Electronic money is also easily transacted through e-commerce, letting consumers conveniently shop for goods and services online.

Reviewed by Andrew Bloomenthal Updated Apr 18, 2019