Digital Money: What It Is, How It Works, Types, and Examples

DEFINITION
Digital money is a form of currency that exists only in electronic form, enabling transactions and financial activities without cash or tangible assets.

What Is Digital Money?

Digital money is any means of payment that exists in a purely electronic form. Digital money is not physically tangible, like a dollar bill or a coin. It is accounted for and transferred using online systems.

Digital money generally represents fiat currencies, such as dollars or euros. It is exchanged using computers, smartphones, cards, and online cryptocurrency exchanges. In some cases, it can be converted into physical cash using an ATM.

KEY TAKEAWAYS

- Digital money is money in purely digital form. It is not a tangible asset like cash or commodities.
- Digital money streamlines financial infrastructure, making it cheaper and faster to conduct monetary transactions. It can also make it easier for central banks to implement monetary policy.
- Examples of types of digital money are central bank digital currencies, cryptocurrency, and stablecoins.
- Because software and networking are essential components of digital money, it is susceptible to hacks.

Understanding Digital Money

Digital money is similar in concept and use to its cash counterpart in that it can be a unit of account and a medium for daily transactions - it is treated the same as cash. For example, the dollars in your bank account are digital - banks no longer store physical cash for clients. When you make a cash deposit to a bank, it adds numbers to

your account and reissues those bills to other customers. If you make a cash withdrawal, the bank converts your digital dollars to cash, subtracts the amount from your account, and gives you physical bills.

This makes financial transactions much faster and cheaper, especially concerning cross-border payments and remittances. Given these advantages, digital money has become a priority for several governments around the world.

For example, the central bank of Sweden, a country that has been researching a cashless society, has released several exploratory papers since 2017 that explore the benefits and drawbacks of introducing digital money into its economy.

China released the digital renminbi (e-CNY), the digital equivalent of its national currency, and began using it to pay government employees; the Bahamian sand dollar was introduced in 2020.

FAST FACT

Digital money makes it easier for central banks to implement monetary policy because they don't need to collect and store physical money or assets to influence inflation or create financial system stability.

What Problems Does Digital Money Solve?

Several systems already perform transactions with digital versions of money. For example, credit card systems let you purchase goods and services on credit. Wire transfer systems enable the movement of cash across borders.

Such transactions are expensive and time-consuming because they involve disparate processing systems. The SWIFT system, a payments system network consisting of various banks and financial institutions across the globe, is an example - each transfer conducted through the SWIFT network has an associated charge. SWIFT member institutions also function in a patchwork of regulations, each specific to a different financial jurisdiction. Moreover, these systems are built on the promise of future payments, ensuring a time lag for each transaction. For example, reconciliation for credit cards occurs at a later date, and users can file chargebacks for transactions.

One of the aims of digital money is to do away with the time lag and operating costs inherent in current systems by using distributed ledger technology (DLT). In a distributed ledger system, shared ledgers are connected via a common network to record transactions. Entities across jurisdictions can connect, which minimizes

processing times. It also provides transparency to authorities and stakeholders. Because the ledger is stored on multiple machines, it is difficult to alter it, especially if it is secured through cryptographic techniques.

Advancements in Digital Money

One of the key advancements in DLT systems is historically linked encryption methods that chain blocks together (called a blockchain). Blockchains improve the resiliency of a financial network because they make it very difficult to change records or access them.

A blockchain with a decentralized and distributed validation mechanism also solves the double-spending problem, where a digital asset can be spent more than once because there is no physical transfer. When there is an extensive network of automated validators checking encrypted transactions linked by historical information, double-spending is not possible. A large and powerful network is orders of magnitude faster than individual computers or small groups, which cannot keep up with the processing rates of the bigger networks. This speed makes a network uneconomical and exceedingly hard to hack.

Third parties can be eliminated in transactions using blockchains and distributed ledgers; blind signatures hide transacting parties' identities; zero-knowledge proofs encrypt transaction details, and encryption adds extra security. Examples of this type of digital money are cryptocurrencies like Bitcoin and Ethereum.

Types of Digital Money

Thanks to its technological underpinning, digital money can be adapted to suit multiple purposes and can take on various forms. Besides the digital representation of cash currently used, there are a few more - and it is likely more will emerge.

Central Bank Digital Currencies (CBDCs)

Central bank digital currencies (CBDCs) are currencies issued by a country's central bank. They are separate from fiat currencies, backed by the authority and credit of a central bank, and are another obligation of the institution.

CBDCs are newborns when it comes to digital money. Some countries have implemented them, but many remain vigilantly observant, waiting to see how the idea works out in the countries experimenting with it.

There are even suggestions for different types of CBDCs. For instance, a type called a wholesale CBDC could be used in transactions between banks and financial institutions for wholesale payments—large or high-value payments between institutions. Retail CBDCs and cryptocurrencies could be designed for daily transactions by consumers and businesses, much like fiat currencies.

Cryptocurrencies

Cryptocurrencies are digital currencies designed using cryptography. They are more commonly known as virtual currencies, a subclass of digital currencies, in an effort to distinguish them from officially recognized money.

The crypto wrapper around a digital currency provides enhanced security and makes transactions tamper-resistant. Since 2017, the popularity of cryptocurrencies as an investment class has skyrocketed the market capitalization of crypto markets.[5] By November 2021, the market cap of cryptocurrencies was almost $3 trillion.[6] The crypto winter of 2022 saw the total crypto market cap drop below $1 trillion, but it began recovering in 2023, climbing to more than $2.5 trillion in March 2024. The market rallied to over $4 trillion in October 2025. However, as of September 2026, the crypto market cap rests at $2.6 trillion.

Stablecoins

Stablecoins are a variation of cryptocurrencies and were developed to counter the price volatility of regular cryptocurrencies. Stablecoins can be likened to a form of private money whose price is tied to that of a fiat currency or a basket of goods to ensure that they remain stable. They can be a proxy for fiat currencies; except they are not backed by governmental authority. The market for stablecoins has exploded in recent times. As of September 2026, 313 stablecoins were listed on CoinMarketCap, the popular cryptocurrency data aggregator; most of which were not showing activity.

Advantages of Digital Money

The current financial infrastructure is a complex system of many entities. Conducting transactions between financial institutions takes time and money because they work in different technological systems and regulatory regimes. The main advantage of digital money is that it speeds up transactions and cuts back on costs.

Other advantages of digital money are as follows:

- It eliminates the need for physical storage and safekeeping, a characteristic of cash-intensive systems. You do not need to physically store it in a wallet, safe, or bank vault to ensure your money is not stolen.
- It simplifies accounting and record-keeping. Manual accounting and separate entity-specific ledgers lose their validity to standardization and automation.
- It has the potential to further revolutionize the remittance industry by eliminating intermediaries and reducing the costs associated with cross-border transfers.
- It removes intermediaries and makes it possible to include groups of people previously excluded from the economy. Those who are unbanked can still participate in an economy using digital money.
- Some forms, like cryptocurrencies, allow for more privacy - beneficial for retail users but not for regulators and law enforcement agencies.

Disadvantages of Digital Money

The disadvantages of digital money are as follows:

- It is susceptible to hacking. Even though it removes the need for physical safekeeping, its origins in technology ensure that this form of money becomes a target for hackers, who can access digital applications. A seamless financial infrastructure consisting of digitally connected entities can be brought down by hackers. Hacks on a large scale have the potential to bring a country's financial infrastructure down and become a national security threat.
- Its use can compromise privacy. Cash is anonymous, and it is nearly impossible to track and trace its users, while digital money can be traced. Digital money creates a record and, thus, a trail that can be followed. While this is a disadvantage for those seeking privacy, it is an advantage for law enforcement and regulators who need transparency.
- It has costs as well. For example, cryptocurrencies require custody solutions that prevent hacking. Systems that use blockchains generally also charge transaction fees—network participants are compensated via fees by the blockchain for using their resources.
- In cryptocurrency form, it presents several challenges on the governance and policy framework front. This form of money is uncharted territory for policymakers, although some jurisdictions have created initial regulatory frameworks.

Digital Money and Digital Wallets

Digital wallets serve as the cornerstone of the digital money ecosystem. Digital wallets are the primary interface where users interact with and manage their digital currencies. They provide a secure environment for storing and managing digital money.

A fundamental aspect of digital wallets is their role in facilitating transactions (obviously involving digital money). Users send and receive payments via their digital wallets by interacting with software interfaces. Consider how you've sent money to a friend via popular banking or personal finance applications; these applications may have digital wallets or similar technologies that facilitate transmitting funds.

One of the key advantages of digital wallets is their accessibility and mobility. Users have instant access to their digital money anytime, anywhere, as long as they have an internet connection. This mobility empowers users to make transactions on-the-go using their smartphones or other internet-enabled devices. This concept is one of the primary benefits of cryptocurrency: anyone around the world can have access to banking services that otherwise have been restricted in many areas of the world.

Lastly, security is paramount in the realm of digital money. If it's really easy to move money, it's easy for others to move your money if they get access to your account. Digital wallets may include encryption techniques, multi-factor authentication, and biometric authentication methods to safeguard digital assets.

The Bottom Line

Digital money is a major innovation in financial technology. It overcomes the issues created by cash and makes payment systems faster and cheaper. But it has the attendant dilemmas that technology introduces, as digital money can be hacked and erode privacy. While digital money is still in its early days, it will play an important part in the future of finance.

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