Dear C.E.O.s of America:

You know all that money your companies have been making the last few years? The way profits are at a record high as a share of the economy? You know how the stock market keeps reaching new highs and long-term interest rates near record lows, so you can finance any new investments cheaply? Could you maybe think about spending a little of that money? You know, buy yourself something pretty, like a nice new industrial lathe, a fleet of trucks, new
computers or even a shiny headquarters office building? The rest of us would really, really appreciate it. Thanks!

Love, Everybody Else

Five years into the economic recovery, businesses still aren’t plowing much money into big-ticket investments for the future. Nonresidential fixed investment — what businesses spend on equipment, software, buildings and intellectual property — still hasn’t bounced back to its pre-crisis share of the economy, let alone made up for lost ground from the record lows of 2009. As Justin Lahart notes in The Wall Street Journal, equipment spending in particular has averaged 5.2 percent of the economy over the last five years, down from 6.5 percent over the previous half-century.

If firms increased their spending enough to close that gap, it would mean an extra $220 billion in annual economic activity and perhaps a couple of million more jobs. But there may be even more important and lasting consequences for this lack of spending by businesses.

Capital spending improves worker productivity. And worker productivity improves living standards. Less capital spending by businesses means less investment in the kinds of equipment, software and intellectual property that will make the economy more competitive over the long haul.

The logic is simple. If you have a ditch-digging business and employ one guy with a shovel, you can significantly increase the number of ditches he can dig by spending $30,000 on a Bobcat T190 earth mover — with the trencher attachment. The same could be said of an expensive new software package that makes your sales force log more calls to the right people, or research and development lab equipment that lead to new patents and better products down the road.

The pattern the last three years has been steady increases in the number of hours Americans are working, combined with unimpressive increases in the total value of the stuff we’re making. That is a recipe for terrible numbers on productivity, including a mere 0.5 percent rise in worker productivity for all of 2013. If you believe the first-quarter numbers this year (which deserve some skepticism), the United States experienced a steep 3.2 percent decline in productivity to start this year.
A lot of guesswork goes into measuring, let alone understanding, changes in productivity, but it’s reasonable to see underinvestment by American businesses as a prime suspect in the underperformance.

The question now is whether that is poised to change. The corporate sector would seem to be primed for increasing their level of investment, with profits high, cash hoards strong and capital available on the cheap.

There is most likely some interplay between the weak capital spending numbers and the weak job market of the last few years; there is less incentive to spend money on productivity-enhancing equipment when labor is cheap. As the job market tightens and workers have better leverage to demand wages, spending money on new equipment becomes more attractive. To return to our ditch-digging business, you may be more inclined to spend thousands of dollars on that earth mover when the going rate for a laborer is $12 an hour as opposed to $10.

In that sense, an improving job market could increase capital spending, which in turn would create a virtuous cycle of more economic activity, more jobs and higher productivity growth.

Another reason for optimism on capital spending, made by Scott Anderson, the chief economist of Bank of the West, is that the nation’s factories are starting to run closer and closer to their full capacity, which implies that they will need to spend for more equipment to meet higher demand.

The manufacturing sector is now operating at 77.8 percent of its capacity, according to Federal Reserve data, well above the 76 percent average during the last expansion and not far from the 79.1 percent peak during the mid-2000s.

“As manufacturing approaches full capacity, wage pressures will build and many businesses will be forced to redirect their profits away from stock buybacks and toward actual physical investment, which will help bolster U.S. G.D.P.,” Mr. Anderson writes in a research note.

Let’s hope he’s right. But it’s worth adding that right now, the idea of a wave of business spending is more speculation than reality. Orders for nondefense capital goods excluding aircraft, a good forward-looking measure of companies’ intentions on the equipment front, has bounced around between $70 billion and $71 billion a month for the last three months. It has not exhibited a clear upward trend.
As with so much about this often-frustrating recovery, it’s not enough to see evidence for why things should improve in the future; we need to see it to believe it.

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